European University Institute

DEPARTMENT OF LAW

# Sovereign Wealth Funds in International Economic Law

Michail Dekastros

Thesis submitted for assessment with a view to obtaining the degree of Doctor of Laws of the European University Institute

Florence, 24 June 2016

European University Institute
**Department of Law**

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Not applicable.

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# SOVEREIGN WEALTH FUNDS IN INTERNATIONAL ECONOMIC LAW

Sovereign Wealth Funds have been the new ‘rising star’ of the global economy for a few years. Host States have reacted to their rise cautiously and have quite frequently cited ‘national security’ as a justification for maintaining an absolute degree of freedom in regulating their entry into their markets. This thesis is arguing that a substantial proportion of regulatory concerns that surround the operation of SWFs are actually not of a national security nature—at least as perceived by the relevant instruments regulating investment in International Economic Law. As a consequence, the current regulatory framework screening SWFs investments *a priori* is both legally and normatively problematic and, in fact, it constitutes a form of protectionism.

As an alternative, this thesis suggests that SWFs ought to be primarily regulated *after* their entry into Host States’ markets. In that context, a proper conceptualisation of the principle of non-discrimination that takes into account the ‘regulatory unlikeness’ between SWFs and other market suppliers/investors will allow the Host States to properly regulate them after their entry into their markets. Such a conceptualisation – contrary to usual analyses – draws heavily from International Investment law in order to interpret the relevant provisions of the GATS.

Στους γονείς μου, Μαρία και Ηλία, και στην αδελφή μου, Ηλιάνα

To my parents, Maria and Elias, and to my sister, Iliana

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## ABBREVIATIONS

| | |
|---|---|
| AB | Appellate Body |
| ASEAN | Association of Southeast Asian Nations |
| BIT/BITs | Bilateral Investment Treaty/Treaties |
| Ch/Chrs | Chapter/Chapters |
| CFIUS | Committee on Foreign Investment in the United States |
| CJEU | Court of Justice of the European Union |
| Co | Company |
| DCS | Directly Competitive or Substitutable |
| DSU | Dispute Settlement Understanding |
| EC | European Communities |
| ed/eds | editor/editors |
| ECHR | European Court of Human Rights |
| ECR | European Court Reports |
| ECSC | European Coal and Steel Community |
| edn | edition |
| EEC | European Economic Community |
| eg | exempli gratia (for example) |
| EU | European Union |
| FINSA | The Foreign Investment and National Security Act 2007 |
| fn/fns | footnote/footnotes |
| FTA | Freed Trade Agreement |
| GATS | General Agreement on Trade in Services |
| GATT | General Agreement on Tariffs and Trade |
| GNS | Group of Negotiations in Services (Uruguay Round) |
| HFCS | High-fructose Corn Syrup |
| ICSID | International Centre for Settlement of Investment Disputes |
| ie | id est (it is) |
| IEL | International Economic Law |
| IIA | International Investment Agreement |
| ILC | International Law Commission |
| ILM | International Legal Materials |
| IMF | International Monetary Fund |
| IMF Agreement | Articles of Agreement of the International Monetary Fund |
| Inc | Incorporated |

| | |
|---|---|
| IWG | International Working Group on Sovereign Wealth Funds |
| LCIA | London Court of International Arbitration |
| Ltd | Limited |
| MFN | Most-favoured Nation |
| NAFTA | North American Free Trade Agreement |
| NT | National Treatment |
| OECD | Organisation for the Economic Co-operation and Development |
| OJ | Official Journal of the European Communities |
| PPM/PPMs | Process and production method/methods |
| SPF | Spruce-pine-fir (softwood lumber) |
| SPS | Sanitary and Phytosanitary Measures |
| SSRN | Social Science Research Network |
| SWF/SWFs | Sovereign Wealth Fund/Funds |
| TBT | Technical Barriers to Trade |
| TEU | Treaty on the European Union |
| TFEU | Treaty on the Functioning of the European Union |
| UK | United Kingdom of Great Britain and Northern Ireland |
| UN | United Nations |
| UNCITRAL | United Nations Commission on International Trade Law |
| UNCTAD | United Nations Conference on Trade and Development |
| UNTS | United Nations Treaty Series |
| US/USA | United States of America |
| USC | United States Code |
| VCLT | Vienna Convention on the Law of Treaties |
| vol/vols | volume/volumes |
| WTO | World Trade Organization |

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List of full case names and references for short form citations used in the PhD thesis.

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*A Subject and a Sovereign are clean different things.*

*Charles I, speech on the scaffold, 30 January 1649*[1]

# I. INTRODUCTION

## A. THE REGULATION OF SWFS IN IEL

The words of Charles I almost sound comforting. These days, these conceptual distinctions are nothing but 'clean'. The boundaries between the State and its subjects, the public and the private, law and contract have lost some – if not most − of their meaning. Sovereign Wealth Funds constitute a very apt illustration of such a development.

SWFs have been, for the most past, portfolio investors that purchase financial instruments and minor shareholdings in different jurisdictions in pursuit of return maximisation. Over time, though, they have diversified their investment strategies and it has become increasingly evident that they have now moved into the realm of Foreign Direct Investment.[2] This relatively new development has raised concerns about their activities.

Indeed, the rise of SWFs was accompanied by heated discussions regarding the optimum approach to a possible regulation of their operations in foreign markets. Several States and scholars suggested that a new multilateral regulatory framework under the auspices of an international organisation, such as the IMF, World Bank or OECD, would constitute the most appropriate approach.[3] Others have argued that the current domestic

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1 'King Charls his Speech made upon the Scaffold at Whitehall-Gate immediately before his Execution, on Tuesday the 30 of January 1648. With a Relation of the manner of his going to Execution' in *The Trial and Execution of King Charles I: Facsimiles of the Contemporary Official Accounts Contained in the Charge of the Commons of England against Charls Stuart, King Charls His Tryal, King Charls His Speech Made upon the Scaffold* (Scholar Press Ltd, reprinted 1966), (6).

2 For several SWFs (Brunei, China, Kuwait, Malaysia, Qatar, Singapore, The United Arab Emirates and Vietnam) that have expressly stated that their investment strategies increasingly involve the acquisition of significant or controlling stakes in companies see Edwin M Truman, *Sovereign Wealth Funds: Threat or Salvation?* (Peterson Institute for International Economics 2011) 42; see also Stuart Eizenstat and Alan Larson, 'The Sovereign Wealth Explosion' *Wall Street Journal* (8 November 2007) reporting that China, South Korea and Singapore announced plans to move up to US$480 billion in foreign exchange to riskier investments; for the Norwegian Government Pension Fund, the most conservative of SWFs, which has long ago increased its allocation to equity from 40 to 60 per cent of its portfolio and has diversified and broadened the type of assets it holds see Larry Catá Backer, 'Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance Through Private Global Investment' (2010) 41 Georgetown Journal of International Law 425.

3 See *infra* Ch II, fns 220−232 and accompanying text.

legal framework is best suited to address the most common regulatory concerns[4] and that the most dangerous risk lies in the threat of protectionism anyway.[5]

All these approaches, however, seem to be failing to address one very important preliminary question; namely, whether the current regulatory framework is inadequate or ill-suited to accommodate the phenomenon. In that context, the important role that the International Economic Law has to play in this debate will be highlighted.

Indeed, the disciplines of IEL and, more specifically, the methods it employs in order to resolve the tensions between investment promotion, national security and domestic regulatory considerations are largely absent from the debate—ignoring the fact they have been ongoing for decades in the field of IEL. As a consequence, the aim of this thesis is not to suggest ways to regulate SWFs at the international level – let alone domestically – but a rather more modest one; to attempt to examine the current domestic regulatory responses of host States to the phenomenon of SWFs through the lens of the disciplines of IEL. In that context, it will be suggested that IEL can provide a proper conceptual, as well as regulatory, framework that both addresses the regulatory concerns of the recipient States – by maintaining a certain level of regulatory space – but at the same time, guarantees non-discriminatory treatment of SWFs and a welcoming environment for SWF investments.

More specifically, the main response of recipient States to SWFs' investments in their markets was to either set up or enhance the competencies of 'foreign investment screening mechanisms'. These mechanisms screen foreign investments *before* their entry into the relevant market and can either restrict or block them entirely.

The first claim of this thesis is that these regulatory strategies – unlike what many host States have often assumed – are covered by the scope of application of several different International Treaties. In that context, the most relevant Treaties, which will be examined, are the General Agreement on Trade in Services,[6] the universe of Bilateral

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4 See *infra* Ch II, fns 136−138 and accompanying text.

5 See, eg, Brendan J Reed, 'Sovereign Wealth Funds: The New Barbarians at the Gate – An Analysis of the Legal and Business Implications of Their Ascendancy' (2009) 4 Virginia Law and Business Review 97; Richard A Epstein and Amanda M Rose, 'The Regulation of Sovereign Wealth Funds: The Virtues of Going Slow' (2009) 76 The University of Chicago Law Review 111; Ronald J Gilson and Curtis J Milhaupt, 'Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism' (2007-2008) 60 Stanford Law Review 1345.

6 General Agreement on Trade in Services, April 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, The Legal Texts: the Results of the Uruguay Round of Multilateral trade Negotiations 284 (1999), 1869 UNTS 183, 33 ILM 1167 (1994).

Investment Treaties, as well as several new-generation Free Trade Agreements with Investment chapters.[7] Indeed, given that the majority of foreign direct and portfolio investment takes place in the field of services, a dense, yet incoherent, regulatory framework that comes into play and regulates the admission and establishment of SWFs' investments is becoming increasingly visible. Thus, it will be argued that these 'foreign investment screening mechanisms' and the wide discretion they seem to enjoy, contravene several IEL obligations as it stands, at least with respect to pre-establishment rights of SWF investors.

This first set of conclusions, which *prima facie* suggests a much more limited regulatory space for host States when dealing with SWFs' investments, could be rather troubling for them. Indeed, domestic constituents often feel uncomfortable when they realise that their State's regulatory space has actually been limited. Further, the uncertainty deters potential investors, thus also limiting the flow of and increasing the cost of capital. This problem becomes even more acute in the case of SWFs mainly for two reasons. First, SWFs are big institutional investors managing trillions of dollars and, thus, their behaviour possesses an important signalling effect in the global market. Their potential withdrawal from a market could create major volatility and shatter confidence in the market itself. Therefore, recipient States would be quite keen on both attracting foreign investment by SWFs and on keeping them in the market when problems arise. On the other hand, due to the *sui generis* nature of SWFs, some legitimate and very important regulatory concerns surrounding their operation do arise. The hybrid public-private nature of SWFs raises important issues of transparency, corporate governance and national security, to name a few.

It becomes quite clear then that the stakes are very high and that friction between States is likely to manifest in the future as a result of the operation of SWFs in their respective markets. SWFs will tend more and more to assert their rights under several international treaties that regulate the global and increasingly globalised economy.[8] Conversely, recipient States will become more and more aware of the problems that arise out of the operation of SWFs within their markets while they will be tempted to protect sectors of their economy. Therefore, there is a great potential for a collision between these groups of countries that will undoubtedly harm the international economy.

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[7] See, eg, Trans-Pacific Partnership Agreement (signed in Auckland, New Zealand on 4 February 2016).

[8] See *infra* Ch III.

Things do not have to go this way. Indeed, it is in the interest of host States to promote the free flow of investment within their borders. At the same time, SWFs' home States can make sure that protectionist regulation is distinguished from transparent regulation aimed at addressing legitimate regulatory concerns. In that context, the framework of IEL can provide a very effective and efficient institutional setting for resolving these thorny issues. Unfortunately, the area of investment in services, the area where most of these SWFs operate, has not been widely researched so far.[9]

In that context, it will be further submitted, that the substantive provisions of IEL are very well suited to strike a balance between the competing goals of SWF investment promotion and host State regulation. Namely, contrary to current approaches that restrict or block SWF investment 'at the border', it will be claimed that – in the majority of cases – a better approach would be regulate their operation *after* their entry into the host State market. Such an approach can be very well supported by a proper conceptualisation of the principle of non-discrimination in IEL. Pursuant to this reasoning, the crux of the matter in regards to SWFs' regulation is whether these funds are actually '*like*'[10] other private investment funds or other similar entities. In some instances the evidence might suggest that they are 'like' other *market suppliers* or 'like' other *investors* and no differential in treatment should be accorded to them. In other instances, however, because of their *sui generis* nature, SWFs will be found to be 'unlike' other market suppliers and investors and, thus, host States can treat them differently. Then, any piece of legislation regulating SWFs should be scrutinised under both WTO and Investment Law in order to determine whether the treatment afforded is 'less favourable' and, hence, discriminatory. This thesis submits that this is a rather superior approach since it guarantees market access to SWFs while sanctioning host States to address their legitimate regulatory concerns without resorting to protectionism.

Last but not least, even when host States do not assume complete regulatory freedom at the pre-establishment stage of an investment, they often claim that domestic

9 See, however, for some notable exceptions Martín Molinuevo, 'Can Foreign Investors in Services Benefit from WTO Dispute Settlement? Legal Standing and Remedies in WTO and International Arbitration' in Marion Panizzon, Nicole Pohl and Pierre Sauvé (eds), *GATS and the Regulation of International Trade in Services* (Cambridge University Press 2008); Martín Molinuevo, *Protecting Investment in Services* (Kluwers Law International, The Netherlands 2012); Rudolf Adlung, 'International Rules Governing Foreign Direct Investment in Services: Investment Treaties versus the GATS' (2016) 17 The Journal of World Investment & Trade 47.

10 The notorious term 'like' constitutes one of the cornerstones of the WTO Agreements. For a detailed analysis see *infra* Ch III.

'foreign investment screening mechanisms' are *exempted* from scrutiny under the relevant GATS' and BITs' National Security exceptions. This approach, it will be submitted, is also problematic for two reasons. First of all, as a matter of law, national security exceptions are not wide enough to excuse the wide competencies that have been entrusted to the domestic 'foreign investment screening mechanisms'. Indeed, as will be argued, the scope of application of these exceptions is significantly less wide than commonly assumed by host States. Furthermore, this approach is also normatively problematic; indeed, once the threshold for the invocation of these exceptions is met, the regulation of SWFs by the host States completely escapes the scrutiny of WTO and Investment Law and, thus, constitutes an open invitation to protectionism.

The search for accountability is a symbiotic process. It requires careful sequencing. SWFs need and have begun to address deficiencies in their own governance. Recipient countries have, to date, succeeded only in erecting artificial barriers to entry that lack consistency and are, in fact, merely a cover for nascent protectionism.[11]

## B. THE SCOPE, STRUCTURE AND METHODOLOGY OF THE THESIS

The aim of this thesis is to analyse the phenomenon of SWFs as actors in IEL using the several relevant agreements as a conceptual framework. Therefore, the research question is whether the regulatory concerns that have arisen as a result of the operation of SWFs in foreign markets can be addressed through the current framework of IEL or whether a new international regulatory framework is needed.

In that context, the familiar concepts of 'pre-establishment protection', 'national security', 'likeness', 'less favourable treatment', and 'regulatory intent' will naturally feature in the analysis and their accompanying debates will be explored. However, a further aspiration of this thesis is to shed light to the notion of non-discrimination in the largely under-researched framework of investment in services both under the GATS and International Investment law. In that context, the overlap between these two bodies of law will be explored and an attempt will be made to provide a unified approach to issues of non-discrimination using SWFs (and the Member States' response to them) as a conceptual canvas.

[11] Justin O'Brien, 'Mapping the Trajectory of the Regulatory Debate: Securing the National Interest or Justifying Protectionism?' in Renée Fry, Warwick McKibbin and Justin O'Brien (eds), *Sovereign Wealth: The Role of State Capital in the New Financial Order* (Imperial College Press, London 2011) 167.

In Chapter I of the thesis, an overview of the phenomenon of SWFs will be offered. In this context, the history of SWFs will be presented and an attempt will be made to resolve the thorny issue of defining SWFs. Furthermore, the potential regulatory issues that arise from the operation of SWFs in foreign markets will be presented. It will be argued that the majority of them do not, in fact, concern the national security of host States. On the contrary, they mostly touch upon issues of corporate governance, competition law and transparency. In that context, it will be examined whether the current regulatory approaches pursued by host States as a response to these concerns are appropriate. It will emerge that States have mainly resorted to 'Foreign Investment Screening Mechanisms' that can restrict or block SWF investments at the border by invoking an ill-defined notion of national security. Such an approach, it will be submitted, is inappropriate to deal with the phenomenon, does not resolve any of the specific issues and is verging on protectionism.

In Chapter II of the thesis, the lawfulness of the aforementioned 'foreign investment screening mechanisms' will be examined under the relevant disciplines of IEL. It will be argued that SWFs are actually covered by the scope of application of both the GATS and a substantial number of BITs and FTAs. In that context, SWFs have market access rights under IEL that are negated, as a result of the current regulatory responses of host States. Consequently, it will be argued that the current approach is legally questionable and normatively undesired—since it restricts the free flow of investment without properly addressing the underlying regulatory issues.

In Chapter III of the thesis, it will be argued that the disciplines of IEL can provide an adequate regulatory framework to address the regulatory concerns of host States *after* the entry of SWFs into their relevant markets. In that context, a proper conceptualisation of the principle of non-discrimination will be presented that allows host States to draw regulatory distinctions between SWFs and other economic entities in order to address these concerns. In presenting such a conceptualisation, analogies will be drawn between the International Trade and International Investment regimes and a common framework will be put forth that is applicable to both.

In Chapter VI of the thesis, we will examine situations under which a deviation from protection can be warranted when it comes to SWFs. Indeed, many of the relevant IEL agreements provide for exceptions from their protections when issues of national security arise. Nonetheless, the scope of these exceptions is significantly less wide that often assumed and certainly not wide enough to encompass all the regulatory concerns that stem out of the operation of SWFs. In that context, the scope of these exceptions will be defined and situations where they can be engaged will be presented.

As regards to the methodology of this thesis, the relevant agreements will be treated as part of the wider fabric of Public International Law—obviously not operating in a vacuum. Therefore, the traditional means of interpretation under the VCLT, which are customary in nature,[12] will constitute the tools used to unlock the proper meaning of these agreements. However, given the often-encountered inconsistency of the relevant agreements, in cases of several plausible interpretations, economics and the overall welfare of the world economic system will constitute the guiding principle. Last but not least, a contextual analysis of the same notions under different agreements will be pursued since, as will be submitted, there is often a high degree of textual similarity but also of normative overlap between the agreements. In so doing, however, this thesis will also attempt to provide a perhaps more novel and unified conceptualisation of non-discrimination under WTO and investment law.

Overall, the originality of this thesis lies in the fact that it does not attempt to address the phenomenon of SWFs as a unique type of market entity that necessitates a completely different regulatory framework. This thesis rather attempts to argue that the current international law framework – if properly constructed – is fully capable of addressing the issue and to promote an internationally efficient result for all the parties involved. Further, through this process, this thesis attempts to resolve many issues that concern the field of investment in services, an area that is normatively covered by many different instruments and, yet, is still under-researched.

12 *US – Gasoline* Appellate Body Report, United States – Standards for Reformulated and Conventional Gasoline, WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:I, 3 16; *US – Measures Affecting the Cross-Border Supply of Gambling and Betting Services* WTO Panel, WT/DS285/R, adopted 20 April 2005, as modified by Appellate Body Report WT/DS285/AB/R, DSR 2005:XII, 5797 [6.20], [6.55] *et seq*.

# II. THE RISE OF SFWS AND REGULATORY CHALLENGES

## A. FOUNDATIONS

### 1. The Contemporary Phenomenon of SWFs

The divide between the North and the South, the developed and the developing countries no longer dominates the public discourse in global economic relations. In fact, the flow of capital is not one-sided anymore as the 2008 global financial crisis vividly demonstrated; the West at the time was in dire need of capital injections and some developing countries had accumulated enough wealth to supply it. The vehicles through which this reverse flow of capital from the periphery to the centre was facilitated were the so-called Sovereign Wealth Funds.[1] It is striking that, collectively, SWFs invested \$60 billion in Western banks – such as Citigroup, Morgan Stanley and Merrill Lynch – in just over 6 months in 2008,[2] softening the effects of the subprime mortgage crisis in the process.

SWFs are the new rising star of International Economic Law. They have displayed a vast expansion over recent years both in number[3] and in value of total assets managed by them; according to some estimates, their total assets today amount to USD 1.5−2.5 trillion and roughly equal the combined assets of all hedge funds and private equity firms.[4] Indicatively, the Abu Dhabi Investment Authority – the largest SWF in the group

1 Contrary to the general rule that 'capital historically tended to glow from the core of an economic system to its periphery'; see Philipp Hildebrand, *The Challenge of Sovereign Wealth Funds* (BIS Review, 150/2007, 2007) 4.

2 See David Enrich, Robin Sidel and Susanne Craig, 'How Wall Street Firms Reached out to Asia' *Asian Wall Street Journal* (17 January 2008) 19; Katharina Pistor, 'Sovereign Wealth Funds, Banks and Governments in the Global Crisis: Towards a New Governance of Global Finance' (2009) 10 European Business Organization Law Review 333.

3 20 new Sovereign Wealth Funds have been established since 2000 with 12 of them after 2005; for more on this point see Mathias Audit, 'Is the Erecting of Barriers Against Foreign Sovereign Wealth Funds Compatible with International Investment Law?' (2009) 10 Journal of World Investment and Trade 617; Gerard Lyons, 'State Capitalism: The Rise of Sovereign Wealth Funds' (2008) 14 Law and Business Review of the Americas 179.

4 Heike Schweitzer, 'Sovereign Wealth Funds: Market Investors or "Imperialist Capitalists"? The European Response to Direct Investment by Non-EU State-controlled Entities' (2011) European Yearbook of International Economic Law 79, 85; Julie Kozack, Doug Laxton and Krishna Srinivasan, 'Sovereign Wealth Funds and Global Capital Flows: A Macroeconomic Perspective' in Renée Fry, Warwick McKibbin and Justin O'Brien (eds), *Sovereign Wealth: The Role of State Capital in the New Financial Order* (Imperial College Press, London 2011) 21.

– had a combined value of assets of US$ 625−875 billion in early 2009.[5] Furthermore, it is estimated that they will continue to grow due to the same factors that sparked their growth, such as the unrestricted international flows of capital, predicted trends in commodity prices and foreign exchange reserves, high growth in transition economies, demands on the public pension systems of aging societies, and high internal rates of return on the funds themselves.[6] Indeed, it was presumed that by 2014 they had grown up to USD 4–6 trillion[7] and some analysts have predicted that, by the end of the decade, total assets under their management will reach $13.4 trillion.[8] Nonetheless, their combined assets are minute compared to the 'global value of traded securities [which] is about US$ 165 trillion'[9] whilst SWFs are also small compared with the US$ 62 trillion funds managed by private institutional investors.[10] However, they are increasingly investing abroad and moving into alternative assets.[11]

Such a move from portfolio to Foreign Direct Investment ('FDI') can be perceived as quite positive from an economics perspective. Indeed, equity investments facilitate the recycling of trade surpluses and increase the supply of funds to the equity market, thus reducing the cost of capital.[12] Furthermore, equity investment, as compared to investment in debt, is also more stable as its withdrawal is less disruptive than a withdrawal from a debt market.[13]

In light of their sudden rise though, it comes as no surprise that their investment strategies have invited an increasing amount of scrutiny from the recipient States.

[5] Xu Yi-chong, 'The Political Economy of Sovereign Wealth Funds' in Xu Yi-chong and Gawdat Bahgat (eds), *The Political Economy of Sovereign Wealth Funds* (Palgrave Macmillan 2010) 5.

[6] Ronald J Gilson and Curtis J Milhaupt, 'Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism' (2007-2008) 60 Stanford Law Review 1345, 1360.

[7] Kozack, Laxton and Srinivasan (n 4) 31.

[8] Lyons (n 3) 5.

[9] Simon Johnson, 'The Rise of Sovereign Wealth Funds' (2007) 44 Finance and Development 56, 56.

[10] Yi-chong (n 5) 11.

[11] See Adrian Blundell-Wignall, Yu Wei Hu and Juan Yermo, *Sovereign Wealth and Pension Fund Issues* (OECD Working Papers on Insurance and Private Pensions No 14, 2008).

[12] Gilson and Milhaupt (n 6) 18.

[13] This is due to the fact that, unlike government debt, SWFs cannot hold equity investments until they mature and then decline to reinvest; see Craig K Elwell, Marc Labonte and Wayne M Morrison, *Is China a Threat to the US Economy?* (Congressional Research Service, Report for Congress, 2007) 45.

Indeed, relatively recently their operations have become much more visible [14] and Western countries have appeared uncomfortable and somewhat unprepared for this development. Despite their economies' need for capital they have strived to maintain a supervisory role over its flow, and their regulatory approaches often reflect a protectionist agenda that is at odds with this new reality. In fact, SWFs have been called the 'new bogeymen of global finance'.[15]

Summers was amongst the first ones to voice his concerns about the operation of SWFs abroad—albeit confusing some SOEs with SWFs:

> In early 2007, government-controlled Chinese entities took the external stake (albeit non-voting) in Blackstone, a big private equity group that, indirectly through its holdings, is one of the largest employers in the US. The government of Qatar is seeking to gain control of J. Sainsbury, one of Britain's largest supermarket chains. Gazprom, a Russian conglomerate, in effect controlled by the Kremlin, has strategic interests in the energy sectors of a number of countries and even stake in Airbus. Entities controlled by the government of China and Singapore are offering to take a substantial stake in Barclay's, giving it more heft in its effort to pull off the world's largest banking merger, with ABN Amro.[16]

Furthermore, two highly controversial incidents in the US illustrate the political sensitivity that ensued after 9/11, especially in relation to SWFs' investments. In 2005, China National Offshore Oil Corporation (CNOOK), 70% of which is owned by the Chinese government, withdrew a US$18.2 billion takeover bid for Californian energy firm Unocal Corporation due to political opposition.[17] Similarly, a Dubai company, Dubai Ports World, withdrew its bid to acquire London-based Peninsular and Oriental

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14 For instance, in 2008, the investment and real estate arms of Dubai World acquired a 20% stake in Cirque du Soleil – the world's largest live entertainment business – whilst in 2007 Borse Dubai purchased a 19.9% stake in the NASDAQ Stock Market (whilst simultaneously acquiring NASDAQ's 28% interest in the London Stock Exchange); see, respectively, Paul Blyschak, 'State-Owned Enterprises and International Investment Treaties: When are State-Owned Entities and Their Investment Protected?' (2010–2011) 6 Journal of International Law and International Relations 1, 4 and Kaura Badian and Gregory Harrington, 'The Politics of Sovereign Wealth: Global Financial Markets Enter a New Era' (2008) The International Economy 52, 55.

15 See John Plender, 'An Unseen Risk in Sovereign Funds' *Financial Times* (21 June 2007).

16 Lawrence Summers, 'Sovereign Funds Shake the Logic of Capitalism' *Financial Times* (30 July 2007).

17 See Ben White, 'Chinese Drop Bid to Buy US Oil Firm' *Washington Post* (2 August 2005); For more information on this case from a legal perspective see Deborah M Mostaghel, 'Dubai Ports World Under Exon-Florio: A Threat to National Security or a Tempest in a Seaport' (2006–2007) 70 Albany Law Review 583.

Steam Navigation Company, which had operations at six major ports, including New York and Baltimore.[18] Although it was initially allowed to proceed, subsequent congressional and media attention ultimately caused the company to sell the US portion of the business to a US company.[19]

Admittedly, such controversies have become less common these days mainly as a result of the 2008–2010 crisis, which has caused many previously sceptical states to re-evaluate their attitude towards incoming SWFs' investments.[20] Indeed, leading Western-based corporations and governments are aggressively pursuing sovereign direct investment and 'public calls for opening financial markets to SWFs are now abundant.[21]

Nonetheless, if this change of heart is the result of the crisis, the concerns are likely to return when the economic environment changes. Further, a transparent and coherent regulatory architecture has yet to be devised whilst political controversies continue to play a critical role in SWFs' investment strategies.[22] Indeed, there are signs that international disputes between SWFs and host states are already surfacing.[23]

### 2. The Origins of SWFs

The origins of SWFs can be arguably traced back to 1816 when France created the *Caisse des Depots et Consignations* (CDCO) to manage government and overseas tax-exempt funds collected by French savings banks and post offices.[24]

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18 See Jonathan Weisman and Bradley Graham, 'Dubai Firm to Sell US Port Operations' *Washington Post* (9 March 2006).

19 ibid; see also Joshua W Casselman, 'China's Latest Threat to the United States: The Failed CNOOC-UNOCAL Merger and Its Implications for Exon-Florio and CFIUS' (2007) 17 Indiana International & Comparative Law Review 155.

20 Veljiko Fotak and William Megginson, 'Are SWFs Welcome Now?' (21 July 2009) 9 Columbia FDI Perpectives accessed 20 September 2015.

21 See Lyons (n 3).

22 Blyschak (n 14) 9–10.

23 See, eg, Luke Eric Peterson, 'Oman's Sovereign Wealth Fund is the Latest Claimant to Try to Hold a Sovereign State – this Time, Bulgaria – Liable for Losses Tied to a Bank Failure' Investment Arbitration Reporter, 23 October 2015 accessed 26 October 2015; for a number of disputes that have involved State-Owned Enterprises but not SWFs *stricto sensu*, see Claudia Annacker, 'Protection and Admission of Sovereign Investment under Investment Treaties' (2011) 10 Chinese Journal of International Law 531, 552–553 and accompanying footnotes.

24 Yi-chong (n 5) 1.

More recently, the predecessors of contemporary SWFs were the so-called 'stabilisation funds'. These funds were intended to shield governments dependent on royalty revenue[25] from the high volatility of commodity prices.[26] The first Fund of this sort was created by Kuwait in 1953 and its purpose was to manage excess oil revenue by allocating a fixed percentage of all sales into the fund since the extreme volatility of oil prices rendered budgetary planning extremely challenging.[27]

The establishment of 'sovereign funds' only became a trend in the 1970s and 1980s when a number of governments recognised the need to mitigate the risks of commodity volatility and to maintain a steady flow of government revenue. It is during this era that the United Arab Emirates, Chile and Brunei established their first sovereign funds using commodity revenue as their capital. Another category of stabilisation funds is the one created by countries that sustain large current account surpluses. These countries have accumulated large foreign exchange reserves as a consequence of their vast trade surpluses and channelled them into funds in order to sterilize the economy from excessive liquidity as well as to seek higher returns than cash or low-yielding government debt held by the Central Bank.[28] The most notable example falling in this category is China, which holds more than US$3.3 trillion in foreign exchange reserves,[29] with Singapore being a similar example.

The purpose of stabilisation funds is quite different than those of modern-day SWFs, as they constitute a self-insurance policy (having been described as 'rainy-day' funds).[30] Their fundamental purpose was to provide a government-controlled account that could be used in periods of falling tax revenues to continue public investment schemes.[31]

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25 Royalties are defined as payments to an owner for the use of property, especially patents, copyrighted works, franchises or natural resources.

26 Christopher Balding, *Sovereign Wealth Funds: The New Intersection of Money and Politics* (Oxford University Press, USA 2012) 2.

27 See Robert Weiner, *Managing Petroleum Fiscal Dependence: Lessons from Venezuela and Mexico* (The Center for Latin American Issues, George Washington University, Washington DC, 2000).

28 Balding (n 26) 5.

29 ibid 5.

30 The term was first used for the US equivalent of these funds, the so-called 'State Funds'; see James W Douglas and Ronald Keith Gaddie, 'State Rainy Day Funds and Fiscal Crises: Rainy Day Funds and the 1990–1991 Recession Revisited' (2002) 22 Public Budgeting & Finance 19.

31 Balding (n 26) 7.

These 'stabilisation funds' constitute the precursors of modern SWFs. Despite the fact that SWFs seem quite similar in their structure, they differ in two main ways. First, instead of focusing on smoothing out public investment and public consumption, their investment mandates require them to earn a specified yearly return against a certain benchmark.[32] Therefore, their prime task is maximising returns on capital and not reducing macroeconomic volatility. As a result, their focus has shifted away from the domestic economy and towards the global economy and financial markets.[33] In that context, instead of investing almost exclusively in government securities and foreign reserves, they tend to have a rather diversified investment strategy that includes investments in equity and corporate securities. Second, the mere fact that, on occasion, these funds have accumulated tremendous sums of capital has led to their initial purpose being superseded; namely, if SWFs were indeed still attempting merely to stabilise the economies of the respective home States, they would need far less capital than they have now.[34] As a consequence, maximising their returns has become their overarching purpose instead.

However, this description of the historical evolution that led to modern-day SWFs only inadequately captures their true nature. There has been significant controversy about how to properly define SWFs and we will attempt to choose the most proper definition for the purposes of this thesis in the next sub-section.

### 3. Defining SWFs

A myriad of definitions have been put forth in the literature discussing SWFs.[35] As a relatively recent phenomenon, both States and academics have struggled to come up with

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32 ibid 15.

33 ibid 16.

34 Patricio Arrau and Stijn Claessens, *Commodity Stabilization Funds* (World Bank Policy Research Working Paper WPS 835, 1992).

35 For some of the most notable ones see Edwin M Truman, *Sovereign Wealth Funds: the Need for Greater Transparency and Accountability* (Peterson Institute for International Economics, 2007); Andrew Rozanov, 'Who Holds the Wealth of Nations?' (2005) 15 Central Banking Journal 52; Rober M Kimmitt, 'Public Footprints in Private Markets-Sovereign Wealth Funds and the World Economy' (2008) 87 Foreign Affairs 119; Roland Beck and Michael Fidora, 'The Impact of Sovereign Wealth Funds on Global Financial Markets' (2008) 43 Intereconomics 349; Stephen L Jen, *The Definition of a Sovereign Wealth Fund* (Morgan Stanley, 2007). Additionally, there is a body of research that focuses primarily on the distinction between Sovereign Wealth Funds and State-owned Enterprises. For the most characteristic example see Larry Catá Backer, 'Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State-owned Enterprises, and the Chinese Experience' (2010) 19 Transnational Law & Contemporary Problems 101.

a definition that comprehensively describes SWFs, especially in distinction to other financial or investment vehicles. Defining SWFs is quite important, to the extent that it assists in properly designing a regulatory framework for their operations. In the context of this thesis though, this task is not of primary importance. The overarching purpose of this thesis is rather to define the limits that IEL places upon such domestic regulation. Namely, domestic regulation of any market actor often conceals protectionist purposes and the role of IEL is to limit or even outlaw such protectionist regulation. Despite that, it is worth presenting a description of the efforts to define SWFs in order to more accurately conceptualise their nature, operations and role in the global economy today.

The term 'SWFs' for was first coined by Rozanov, who defined them as 'funds which are sovereign owned and managed and are not prudential monetary reserves or traditional pension funds'.[36] The widest of these definitions describe them as 'pools of assets owned and managed directly or indirectly by government to achieve national objectives'.[37] Under this definition, all national or sub-national pension funds of a public nature should be included in the definition of SWFs.[38] It has been suggested that such a wide definition would render the term SWFs meaningless since, presumably, any sovereign fund of any nature would fulfil these criteria.

It has also been suggested that SWFs can be classified on the basis of their liabilities: namely, contingent liabilities (typical of stabilisation funds), fixed future liabilities (typical of national pension reserve funds), mixed liabilities (perpetual capital with interim outflows) and open-ended liabilities (effectively no contractually attached liabilities).[39] Pursuant to such a classification, it could be argued that if a Sovereign Fund's capital is accompanied by offsetting liabilities towards, eg, future pensioners or future generations, then, as a result, it would not enjoy any net wealth.[40] Furthermore, it has been argued that monetary authorities that hold a certain amount of exchange reserves for prudential policy purposes should also be excluded from the definition of

36 See Rozanov (n 35); see also Andrew Rozanov, 'A Liability-Based Approach to Sovereign Wealth' (2008) 18 Central banking Journal 31.

37 See Blundell-Wignall, Hu and Yermo (n 11) 3.

38 Truman (n 35) 7; see also Steffen Kern and others, *Sovereign Wealth Funds – State Investments on the Rise* (Deutsche Bank Research, 2007).

39 Andrew Rozanov, 'Sovereign Wealth Funds: Defining Liabilities' (1997) 9 Revue d'Économie Financière 283, 284.

40 Beck and Fidora (n 35) 354.

SWFs since they cannot be viewed as holding wealth.[41] Arguably though, if they in fact accumulate significant ‘excess reserves’ of what would be required to fulfil their policy goals, then these excess reserves could still be regarded as constituting sovereign wealth.[42]

The IMF was probably the first international institution that provided both a definition and a purpose-based classification—partly having in mind the aforementioned academic debates. According to it, SWFs are funds operated by governments aimed at achieving various objectives and are created by allocating funds intended for long-term investments.[43] This definition is built on the contested assumption that pension funds have to be excluded from the definition of SWFs.[44] A further criticism is that a classification based on the investment strategies of SWFs is counterintuitive—even the IMF itself later on admitted that these can be extremely diverse and vary significantly over time.[45]

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41 Andrew Rozanov, ‘Definitional Challenges of Dealing with Sovereign Wealth Funds’ (2011) 1 Asian Journal of International Law 249, 252.

42 ibid 252.

43 See Sovereign Wealth Funds – A Work Agenda (Washington DC, 29 February 2008) which proposes the following definition:

> SWFs are special purpose public investment funds, or arrangements. These funds are owned or controlled by the government, and hold, manage, or administer assets primarily for medium- to long-term macroeconomic and financial objectives (these in principle include: (i) fiscal stabilisation funds; (ii) saving funds; (iii) reserve investment corporations; (iv) development funds; and (v) pension reserve funds – those without explicit pension liabilities – while they exclude *inter alia*: (a) government-employee pension funds; (b) social security funds; (c) government lending funds; and (d) government-owned banks). The Funds are commonly established out of official foreign currency operations, the proceeds of privatisation, fiscal surpluses, and/or receipts resulting from commodity exports. These funds employ a set of investment strategies that include investments in foreign financial assets.

44 For a discussion on the matter see ibid 27; Blundell-Wignall, Hu and Yermo (n 11) 14.

45 See IMF, SWFs – A Work Agenda (n 43) 9:

> SWFs are a heterogeneous group of investors that apply a wide range of investment strategies reflecting their different objectives. When executing their strategic asset allocation (SAA), some SWFs invest solely in publicly listed financial assets (e.g. bonds and equities), while others invest across all major asset classes, including alternative investments. Some SWFs invest relative to market indices and sometimes put additional caps on the maximum holding of each company’s share with a view to ensuring diversification. Other SWFs that aim at maximizing absolute returns over

Shortly after that, at the request of the Congress, the US Government Accountability Office offered a different definition of SWFs on the basis of four criteria: i) that they are government-chartered or government-sponsored investment vehicles; ii) that they invest some or all of their funds in assets other than sovereign debt outside the country that established them; iii) that they are funded through transfers arising primarily from sovereign debt surpluses, trade surpluses, central bank currency reserves or revenues from the commodity wealth of a country; and iv) that they are not actively functioning as a pension fund.[46]

Around the same time, a Working Group was created by the IMF (IWG – International Working Group on Sovereign Wealth Funds), which later evolved into an International Forum composed of high-ranking officials of the IMF and representatives of some leading SWFs. This forum subsequently adopted guidelines (the so-called 'Santiago Principles')[47] that propounded a definition of SWFs that is largely academic and emphasizes three elements supposedly indispensable to it. These are government ownership, activity focusing on the management and administration of equity investments including investments abroad and the aim to develop macro-economic policies.[48] Furthermore, the IWG makes explicit that certain categories of funds are to be excluded from the definition of SWFs; namely, funds operating in domestic markets, central banks, monetary authorities with foreign exchange reserves, government-employee pension funds, state-owned enterprises and funds owned by sovereign owned enterprises are not included.[49]

The EU Commission in a Communication it issued regarding SWFs, it defined them more broadly as 'state-owned investment vehicles that manage a diversified portfolio of

longer time horizons may shift between different asset classes and acquire larger stakes in specific companies that they see as profitable investments.

46 United States Government Accountability Office, *Sovereign Wealth Funds: Publically available Date on Sizes and Investment for some Funds are Limitied* (GAO-08-946, Volume 11, September 2008) 2–3.

47 See International Working Group of Sovereign Wealth Funds, *Sovereign Wealth Funds: Generally Accepted Principles and Practices: 'Santiago Principles'* (2008).

48 ibid, Appendix I.

49 ibid, Appendix I.

domestic and international financial assets'.[50] Unlike the IMF Definition, this one does not seem to exclude pension funds from its ambit.

In the academic literature, Balding offers a more comprehensive definition suggesting that for a sovereign fund is to be characterised as a SWF, it ought to carry three distinct important characteristics.[51] First, it needs to be 'a pool of capital derived from net wealth accumulation'. This requirement would exclude both pension and social security funds as well as funds whose capital is constituted by leveraged debt.[52] Second, a SWF needs to be 'controlled by a government or government-related entity'. This is a largely non-contentious criterion and, in fact, all governments retain some level of control over the management of their funds even if they have been structured in a way that aims to minimise political influence over the commercial and financial nature of their decisions. Third, the last defining characteristic of a SWF is that it 'invests in assets seeking returns above the risk-free rate of return'. This distinguishes SWFs from Central Banks and governments that may also hold cash or tradable instruments in the short-term in order to manage their financing needs. Therefore, under this definition, a SWF needs to assume risks not usually assumed by governments in the normal course of their operations and achieve that by investing in high-rate fixed-income securities that are, nevertheless, diversified well beyond riskless assets.[53]

Overall it has been suggested that each of these definitions or classifications places emphasis either on a subjective or an objective element, namely activity and ownership of the Fund respectively, in order to categorise them.[54] It has also been suggested that, instead of focusing on the activities of a Fund (the subjective element), one should instead focus on the purposes of the Fund's activity.[55] Under such an approach, SWFs

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50 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: 'A common European approach to Sovereign Wealth Funds', COM(2008) 115 provisional, 3.

51 Balding (n 26) 19.

52 See, eg, French Strategic Investment Fund; for more information see <http://www.swfinstitute.org/fund/france.php>

53 Balding (n 26) 20.

54 Backer (n 35) 123.

55 Fabio Bassan, *The Law of Sovereign Wealth Funds* (Edward Elgar Publishing 2011) 24. This proposition is based on the idea that once the proper purposes of the Fund's activity are specified, identifying their investment strategies becomes apparent; for this view see also Arina V Popova, 'Sovereign Wealth Funds:

ought to be described as public entities pursuing public objectives and, thus, any attempt to perceive or regulate them as any other 'private investor' would be erroneous.

Nevertheless, the main common characteristic that we can safely identify in all SWFs is that they are funded and/or owned by a State but are managed separately from official reserves; also, there seems to be a degree of consensus that, unlike pension funds, SWFs have limited or no liabilities.[56] In a nutshell, these definitions suggest that SWFs are special-purpose investment funds or arrangements that share one key feature – government ownership.[57]

Other than that, though, their investment strategies, goals pursued and governance structures are strikingly heterogeneous.[58] SWFs could thus be described as 'chameleon-like', in that they have the ability to deploy different investment strategies, and deal in a myriad of financial instruments, in response to objectives that shift over time.

It is often assumed by many that a formal legal definition of SWFs is necessary to tackle the issues raised by their operation in a foreign market. It is indeed true that a proper conceptualisation of the nature, objectives and operation of SWFs will allow regulators – either at the international or the national level – to design a proper regulatory framework for the efficient and safe operation of SWFs. The criteria proposed so far seem to be overly descriptive and fail to capture the peculiarities that stem from the hybrid nature of SWFs: sovereign entities with public objectives that are best fulfilled when operating efficiently in private economic activities within a marketplace.

Nevertheless, the object of this thesis is not to describe and properly conceptualise their operation for the purposes of regulating their activities. The purpose of this thesis is rather to examine whether domestic regulatory responses of host States with respect to SWFs are in conformity with the principles and commitments that States have undertaken under IEL and to highlight the regulatory space available to host States under these agreements. In that context, giving a very thorough definition of SWFs serves no useful purpose. States may always adopt a definition of SWFs that suits their own –

To Be or Not to Be is Not the Question; Which One to Choose, Is' (2009) 40 Georgetown Journal of International Law 1191.

56 EU Communication on SWFs (n 50) II.2.1; Beck and Fidora (n 35) 354; Kimmitt (n 35) 120.

57 Yi-chong (n 5) 4.

58 See Cornelia Hammer, Iva Petrova and Peter Kunzel, *Sovereign Wealth Funds: Current Institutional and Operational Practices* (IMF Working Paper, November 2008, WP/08/254, 2008); Rozanov, 'Definitional Challenges of Dealing with Sovereign Wealth Funds' (n 58) 251.

often protectionist – purposes but the role of IEL is to delineate the available regulatory space Host States have, irrespective of domestic considerations and legal definitions.

Indeed, it is submitted, the problem with the current legal framework for SWFs lies in the fact that some States seem to hide behind some – limited, it will be argued – regulatory concerns in order to resort to *à la carte* protectionism, often masked in the language of national security. Therefore, and once these regulatory concerns have been identified, we will attempt to ascertain the framework within which the States have the right to regulate SWFs without violating the several agreements under the *acquis* of IEL. In this endeavour, SWFs will be analysed under the definitions for different market actors already provided under the different subsystems of IEL.

## B. The Rationale for Regulating SWFs in Host States

### 1. Introduction

In 2007 and 2008, as a result of the aforementioned investment attempts by SWFs, a scare campaign was rampant in the US and some EU states: SWFs' investment, it was argued, 'might be used for overt or tacit political purposes'[59] that would even go as far as threating countries' national interest by 'hollowing out economies and national flag companies, by taking over national resources and by controlling national infrastructures'.[60] In a similar vein, others emphasised that SWFs might, in reality, prove to be instruments of a 'New Mercantilism' and that, without proper global regulation of SWFs, they may gain access to national security interests, influence politics, create chaos in foreign economies, or destabilise international financial markets.[61] Soon thereafter, a political discussion commenced about how to properly address this new threat but misconceptions once popularised meant that a meaningful debate was stymied. The emerging consensus at the time was clear: SWFs were to be kept out.

59 Benjamin J Cohen, 'Sovereign Wealth Funds and National Security: The Great Tradeoff' (2009) 85 International Affairs 713, 713.

60 Xu Yi-chong, 'Global Disequilibria' in Xu Yi-chong and Gawdat Bahgat (eds), *The Political Economy of Sovereign Wealth Funds* (Palgrave Macmillan 2010) 245.

61 See Truman (n 35) 6–7; see Summers (n 16); see also Gal Luft, *Sovereign Wealth Funds, Oil, and the New World Economic Order* (Speech delivered before the House Committee in Foreign Affairs, 21 May 2008).

Remarkably, and for the first time since at least the formation of the Washington consensus in the 1970s,[62] the West was no longer making the case for dismantling the barriers of protectionism across the world economy; in fact, its response can be described as riding the wave of a New Protectionism against the very states that the West encouraged to adopt free trade and investment policies during the latter part of the 20th century. Indeed, for more than three decades, developing countries were urged to privatise State-owned assets paying little attention to the identity of the buyer, who in some cases was even a western foreign government (for instance EdF).[63] For the West at the time 'it seemed permissible for a foreign government to own the country's assets, but not the country's own government', especially in developing countries, but the reverse situation – when government-owned funds purchase companies in developed countries – is not.[64]

Irrespective of the existence of this 'double standard', there have been some more serious debates in academia and policy circles about the regulatory challenges that the operation of SWFs might pose.[65] Some of the most commonly mentioned regulatory challenges are the risk of transmission of financial market shocks or the exercise of soft political power.[66] Furthermore, issues of corporate governance have arisen since there is little knowledge of SWFs' investment strategies or how investment decisions are made within SWFs.[67] Most importantly, however, – given that more than two-thirds of SWFs are located in countries that are both politically and financially less open than OECD

[62] See, eg, John Williamson, 'A Short History of the Washington Consensus' (2009) 15 Law & Business Review of the Americas 7; Charles Gore, 'The Rise and Fall of the Washington Consensus as a Paradigm for Developing Countries' (2000) 28 World development 789.

[63] Some State-owned corporations from developed countries such as the French EDF and Areva or the Atomic Energy of Canada (AEC) in the nuclear industry have been active investors across a whole range of developing countries; see Yi-chong (n 5) 14; Yi-chong (n 60) 250.

[64] Joseph E Stiglitz and Members of a UN Commission on Financial Experts, *The Stiglitz Report: Reforming the International Monetary and Financial Systems in the Wake of the Global Crisis* (The New Press 2010) 60.

[65] For a summary of the evolution of such debates over time see Anna Sandor, 'Leveraging International Law to Incentivize Value-Added Shareholding: Why Foreign Sovereign Wealth Funds Still Matter and How They Can Improve Shareholder Governance' (2015) 46 Georgetown Journal of International Law 947, 949 and accompanying footnotes.

[66] Renée Fry, Warwick McKibbin and Justin O'Brien, 'Introduction: Sovereign Wealth Funds in an Evolving Global Financial System' in Renée Fry, Warwick McKibbin and Justin O'Brien (eds), *Sovereign Wealth: The Role of State Capital and the New Financial Order* (Imperial College Press, London 2011) 6.

[67] Yi-chong (n 5) 1–2.

countries, while more than 90 per cent of their overseas investment has gone to OECD countries – there is a fear that SWFs might threaten the national economy and national security of recipient countries.[68]

Nevertheless, there is often a tendency in policy analysis to lump all regulatory challenges that have arisen in connection to SWFs' investments and present them as different facets of a single national security threat. In this thesis, though, it will be submitted that there are distinct regulatory challenges that are not necessarily exclusively related to SWFs and that, in any case, these can be addressed through domestic regulation within the host States' markets. In that context, an attempt at categorising the different regulatory challenges will be made before assessing later on whether they could constitute valid national security threats—as perceived by the disciplines of International Economic Law.

### 2. Economic Efficiency Concerns

The first category of regulatory concerns that arise from the operation of SWFs are the ones related to their capacity to affect the efficiency of the market in which they operate. Namely, it has been argued that if the economic-political rationale ratio of their investment decisions is largely tilted towards the latter, then the proper function of the market itself might be jeopardised.[69] It is widely feared that SWFs' investments will be politically motivated and driven by geo-political rationales[70] rather than the profit maximisation which has been the driving force of all participants in liberal markets

68 ibid 2; Fry, McKibbin and O'Brien (n 66) 6.

69 See Summers (n 16); for a similar argument see Brad W Setser, *Sovereign Wealth and Sovereign Power: The Strategic Consequences of American Indebtedness* (Council on Foreign Relations, Council Special Report No 37, 2008).

70 See, eg, James Politi, 'Sovereign Funds Face U.S. Threat,' *Financial Times* (14 February 2008) (quoting Senator Schumer) citing Senator Chuck Schumer who stated with respect to SWFs: '[so] the bottom line is that we don't know if their decisions are made exclusively on an economic basis'; see also Kathryn Gordon and April Tash, *Foreign Government-Controlled Investors and Recipient Country Investment Policies: A Scoping Paper* (OECD Investment Division, 10 January, 2009) 10 who explain that:

> [W]hen governments undertake commercial activities, they remain answerable to a wide range of societal pressures that their governance structures are designed to take into account. For this reason, governments may encounter difficulties in making credible commitments to pursue only 'commercial' objectives, since their raison d'être involves being sensitive to political pressures and to pursuing non-commercial objectives.

worldwide.[71] Similarly, many policy makers have disputed whether SWFs will work to maximize shareholder value or act as political extensions of the state.[72] In that context, some find the government ownership of SWFs problematic, as being in stark contrast to 'market capitalism'.[73]

Pursuant to this reasoning, SWFs can be envisaged merely as instruments of States that wish to exploit and abuse the capitalist system for their own political and economic benefit.[74] In fact, it has been even suggested that nations whose corporations are targets of investments are threatened with becoming 'sharecropper' states if ownership moves to foreign government absentee holders.[75] Such a development, it is argued, 'calls into question our most basic assumptions about the structure and functioning of our economies and the international financial system'.[76]

Nevertheless, there are powerful objections to such an understanding of the influence of SWFs within a capitalist market economy. First of all, it can be argued that there is nothing 'irregular' in non-commercial considerations affecting the investment decisions of SWFs. Indeed, 'extra-financial' considerations are an integral part of the investment management landscape—regardless of the ownership of these investments.[77] In fact, private investors also take into account non-commercial interests when they, for instance, apply ethical screening prior to their investments or when taking into account considerations of a political nature.[78] For example, in June 2006, the Norwegian SWF

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71 Edwin M Truman, *A Blueprint for Sovereign Wealth Fund Best Practices* (Peterson Institute Policy Brief No PB08-3, 2008) 3; Christopher Balding, 'A Portfolio Analysis of Sovereign Wealth Funds' in Renée Fry, Warwick McKibbin and Justin O'Brien (eds), *Sovereign Wealth: The Role of State Capital in the New Financial Order* (Imperial College Press, London 2011) 44.

72 Balding, *Sovereign Wealth Funds: The New Intersection of Money and Politics* (n 26) 72.

73 Peter Goodman and Louise Story, 'Overseas Investors Buy Aggressively in US' *New York Times* (20 January 2008).

74 See Gilson and Milhaupt (n 6) 1345 who present this view without fully endorsing it.

75 David R Francis, 'Will Sovereign Wealth Funds Rule the World' (*The Christian Science Monitor*, 26 November 2007) accessed 23 October 2015 quoting Warren Buffett.

76 Edwin M Truman, *Sovereign Wealth Fund Acquisitions and Other Foreign Government Investments in the United States: Assessing the Economic and National Security Implications* (Testimony before the Committee on Banking, Housing and Urban Affairs, United States Senate, 2007) 1.

77 For an analysis of this argument see, eg, Richard A Epstein and Amanda M Rose, 'The Regulation of Sovereign Wealth Funds: The Virtues of Going Slow' (2009) 76 The University of Chicago Law Review 111, 125–127.

78 Rozanov, 'Definitional Challenges of Dealing with Sovereign Wealth Funds' (n 41) 262.

disinvested more than US$400 million of its Wal-Mart holdings because of the company's treatment of its workforce—with many cheering this decision.[79] In 2004, the Norwegian parliament adopted ethical guidelines for the Government Pension Fund – Global (GPF-G) – and made certain moral judgements that some investments ought to be prohibited.[80] Indeed, when institutional investors, including SWFs, insist on their 'corporate responsibilities', their investment is often motivated by non-commercial' interests[81] but that has never been perceived as a problem. Arguably, CalPERS and ABP Investments – the two largest US public employee pension funds – or a private equity group like Carlyle with former prime ministers and presidents on its board poses the same regulatory challenges.[82]

Furthermore, these so-called 'non-commercial' motives are not necessarily inefficient from a purely economic perspective. Indeed, it is argued that the idiosyncrasies introduced by such behaviour increase the diversity and heterogeneity of markets that, in turn, positively influence the liquidity of a market;[83] this results in lower costs of capital, which will flow where the greatest promise of return is, thus, promoting efficiency. Moreover, government-owned firms are often revenue and employment maximising instead of profit maximising and that is not necessarily a negative or inefficient outcome.[84] In fact, Atkinson and Stiglitz have argued – in an application of

79 Yi-chong (n 60) 250.

80 See Simon Chesterman, 'The Turn to Ethics: Disinvestment From Multi-National Corporations for Human Rights Violations – The Case of Norway's Sovereign Wealth Fund' (2008) 23 American University International Law Review 577.

81 See Rachel Kyte, 'Balancing Rights with Responsibilities: Looking for the Global Drivers of Materiality in Corporate Social Responsibility and the Voluntary Initiatives that Develop and Support Them' (2008) 23 American University International Law Review 559; see also Joseph E Stiglitz, 'Regulating Multinational Corporations: Towards Principles of Cross-Border Legal Frameworks in a Globalised World Balancing Rights and Responsibilities' (2008) 23 American University International Law Review 451.

82 Avinish Persaud, 'The Political Economy of Sovereign Wealth Funds' in Renée Fry, Warwick McKibbin and Justin O'Brien (eds), *Sovereign Wealth: The Role of State Capital in the New Financial Order* (Imperial College Press, London 2011) 102.

83 Rozanov, 'Definitional Challenges of Dealing with Sovereign Wealth Funds' (n 41) 262.

84 See Paola Sapienza, 'The Effects of Government Ownership on Bank Lending' (2004) 72 Journal of Financial Economics 357; see also John Whalley and Shunming Zhang, *State-owned Enterprise Behaviour Responses to Trade Reforms: some Analytics and Numerical Simulation Results Using Chinese Data* (NBER Working Paper No 12780, 2006).

the economic theory of institutions – that such enterprises might be created to address market failures whenever the social benefits of their activity exceeds the costs.[85]

Last but not least, even assuming these concerns are valid, such behaviour has not been empirically attested. On the contrary, there seems to be empirical evidence SWFs appear to be acting as rational economically-driven investors assuming general market risk.[86] Further, affiliates of SWFs are found to maximise employment and turnover in comparison to private affiliates, suggesting that they bring efficiency gains to the host market.[87]

Therefore, the assertion that SWFs negatively impact the efficiency of the markets they operate in is empirically unattested and theoretically questionable. Even assuming there is an element of concern, however, any regulation to address these issues would need to also concern other institutional investors and not single out SWFs.

### 3. Financial Stability Concerns

A further category of regulatory concerns is the one that questions the role of SWFs in maintaining the stability of financial markets. A financial system is in a state of stability if it is not only capable of facilitating the performance of the economy, as analysed, but it further has the capacity to dissipate financial imbalances that arise endogenously or exogenously.[88]

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85 See Anthony B Atkinson and Joseph E Stiglitz, *Lectures on Public Economics* (Princeton University Press 2015).

86 Balding, 'A Portfolio Analysis of Sovereign Wealth Funds' (n 71) 44; see also Ji Li, 'State-Owned Enterprises in the Current Regime of Investor-State Arbitration' in Shaheeza Lalani and Rodrigo Polanco Lazo (eds), *The Role of State in Investor-State Arbitration*, vol 3 Nijhoff International Investment Law Series (Brill/Nijhoff 2015) 396–398 who has conducted empirical research suggesting that the motives of the foreign investment policies of Chinese SOEs – of which SWFs are a subcategory for the purposes of this paper – vary significantly and very often are not predominantly politically motivated.

87 Sébastien Miroudot and Alexandros Ragoussis, 'New Actors in the International Investment Scenario: Objectives, Performance and Advantages of Affiliates of State-Owned Enterprises and Sovereign Wealth Funds' in Roberto Echandi and Pierre Sauvé (eds), *Prospects in International Investment Law and Policy* (Cambridge University Press 2013) 69–70.

88 See Garry J Schinasi, *Defining Financial Stability* (IMF Working Paper, WP/04/187, 2004) 8 who attempts to define financial stability as:

> A financial system is in a range of stability whenever it is capable of facilitating (rather than impeding) the performance of an economy, *and of dissipating financial imbalances* that arise endogenously or as a result of significant adverse and unanticipated events (emphasis added).

In that context, it has been suggested that a SWF could withhold investment when it is badly needed in the host country, something which would result in 'reinforcing rather than resisting market fluctuations'.[89] Furthermore, some of them manage a very significant number of assets and, consequently, it has been argued that the fact that SWFs 'have not gained experience as major players in international finance'[90] or in managing large investment funds can create financial instability.[91]

Nevertheless, the pertinent question seems to be whether there is anything in particular that differentiates SWF behaviour from other types of investors, public and private. Arguably, it is not government ownership that presents the risk to the host country but the flows or investment *per se*.[92]

Quite the contrary, there is doctrinal and empirical support for the proposition that SWFs rather contribute to the financial stability of a foreign market. Indeed, one difference – other than ownership – between SWFs and other institutional investors is that they have no or limited liabilities and this allows their managers to pursue long-term investment strategies and have a higher risk tolerance and higher expected returns than traditional official reserve managers.[93] This could only have a positive contribution to financial stability of the target countries[94] since, as the literature has long argued, it is short-term investment that creates financial instability and contagious effects.[95]

Note however that, as the author highlights, 'there is as yet no widely accepted model or analytical framework for assessing financial system stability and for examining policies as there is for economic systems and in other disciplines'.

89 Cohen (n 59) 7; see also Bart De Meester, 'International Legal Aspects of Sovereign Wealth Funds: Reconciling International Economic Law and the Law of State Immunities' (2009) 20 European Business Law Review 779, 790.

90 Myriam Senn, *Sovereign Wealth Funds as a Public-Private Challenge for Institutional Governance* (Paper presented at the Sovereign Wealth Funds: Governance and Regulation Conference, National University of Singapore, 9–11 September, 2009) 9.

91 See Hildebrand (n 1).

92 Yi-chong (n 5) 15.

93 See Beck and Fidora (n 35) 358; Peter Kunzel and others, *Investment Objectives of Sovereign Wealth Funds − A Shifting Paradigm* (IMF Working Paper No 11/19, 2011) 5–8.

94 Li (n 86) 381.

95 See, eg, Susan Strange, *Mad Money: When Markets Outgrows Investments* (University of Michigan Press 1998).

Empirically, SWFs have indeed been shown to typically have medium to long-term investment horizons, confirming that they are less likely to make abrupt portfolio shifts but rather, on the contrary, more likely to work as a stabilising force in the economy[96]. As a matter of fact, SWFs were a source of initial capital injections into systematically important financial institutions in the aftermath of the 2008 financial crisis, suggesting that they have already played a stabilising role in global financial markets.[97]

Therefore, the doctrinal and empirical research conducted so far does not seem to indicate that there is something particular in the investment behaviour of SWFs that actually – or even potentially – reinforces financial imbalances.

### 4. Competition Policy Concerns

Another concern that has been voiced is that the operation of SWFs in a given market raises some competition policy questions. Presumably, moving away from a traditional market mind-set could lead to a distortion of competition within and across markets or repeat the unfortunate European experiences of state intervention of the previous century.[98]

Arguably, SWFs may benefit from unfair advantages, creating economic distortions, which in turn could lead to welfare losses.[99] For instance, as pointed out by Capobianco and Christiansen, there is a number of privileges and immunities that could give SWFs a competitive edge: outright subsidisation (either direct or indirect); concessionary financing and guarantees (reducing borrowing costs); other preferential treatment, such as exemptions from antitrust enforcement or preference in public procurement; monopolies and advantages of incumbency; captive equity; exemptions from bankruptcy rules and informational advantages.[100]

Nevertheless, it has been argued that from all the aforementioned privileges, only subsidies and access to capital at a lower cost for cross-border mergers and acquisitions

96 The most vocal proponent of this approach has been the EU Commission which, in that context, has emphasised its commitment to free movement of capital and the need for 'an open investment environment', EU Communication on SWFs (n 50) 4.

97 Kozack, Laxton and Srinivasan (n 4) 33.

98 Schweitzer (n 4) 79.

99 Miroudot and Ragoussis (n 87) 61.

100 See Antonio Capobianco and Hans Christiansen, *Competitive Neutrality and State-Owned Enterprises* (OECD Corporate Governance Working Papers, No 1, 2011).

could constitute a policy issue for SWFs.[101] Arguably, advantages at home such as a privileged tax status, exemptions from the publications of certain law or monopoly rights cannot be carried abroad by affiliates of SWFs.[102]

Even in this scenario though, FDI subsidisation would probably be beneficial to the economy of the host State – with the exception of some more extreme predation scenarios − whilst it is not banned by any international agreement.[103] Arguably, the incentives for foreign governments to subsidize foreign consumers through SWFs operating abroad will normally be rather limited.[104] In any case, these concerns would be better dealt with as issues of competition policy rather than investment policy and, as such, the host States already have the tools to address them—should they ever arise.[105]

### 5. Transparency Concerns

Many have claimed that the operation of SWFs raises significant transparency issues.[106] Nonetheless, claiming that the lack of transparency is an issue *per se* is an unattainable position. At best, a correct formulation of such an argument would be that the lack of transparency could conceal behaviour that raises market efficiency, market stability or competition issues (as previously analysed). In that sense, the lack of transparency is an issue to the extent that it conceals other issues for which regulation would be necessary.

Indeed, not very much is known about the internal governance structures, objectives and investment operations of SWFs[107] and that could be the source of potential instability for global financial markets. More importantly, many studies tend to correlate transparency with democracy and since around two thirds of SWFs are in the hands of non-OECD countries – many of which are categorised as 'flawed democracies'

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101 Miroudot and Ragoussis (n 87) 61.

102 ibid 61.

103 See Gary Hufbauer, Thomas Moll and Luca Rubini, *Investment Subsidies for Cross-Border M&A: Trends and Policy Implications* (United States Council Foundation Occasional Paper No 2, April 2008)

104 Ludwig Gramlich, 'An International Normative Framework for Sovereign Wealth Funds?' (2011) European Yearbook of International Economic Law 62, 115.

105 Miroudot and Ragoussis (n 87) 71.

106 See, eg, Epstein and Rose (n 77) 114.

107 Yi-chong (n 5) 15.

or 'authoritarian regimes' – it is claimed that, by definition, their SWFs could further threaten the stability of global financial markets.[108]

Nevertheless, singling out SWFs and imposing stringent transparency obligations might not be the best policy response for a number of reasons. First, claims for increased transparency have to be balanced against the legitimate business interests of investors since there are limits as to how much information investors should disclose.[109] Second, for optimum results, transparency ought to be reciprocal and host governments should also be more transparent about their policies regarding foreign investment.[110] At the moment, as will be argued later on, their policies are quite opaque and usually discriminatory against specific countries or investment vehicles. More importantly, SWFs are not the only institutional investors with opaque governance and structures; indeed, it has been argued that hedge funds, for instance, 'operate with minimum levels of transparency and public disclosure', if they find it advantageous for their economic interests.[111] Consequently, it has even been suggested that 'forcing SWFs to reveal this information, while allowing private funds to stay silent, would afford the latter an unfair competitive advantage'.[112]

Despite these objections, there are sound policy reasons for regulating at least some transparency requirements in the sovereign wealth sector. It has been suggested that this type of regulation, which would enhance transparency, would provide an early warning system of volatile build-ups of capital within particular sectors and reduce the potential of sudden capital withdrawals causing or amplifying financial crises.[113] Additionally, it could serve broader development aims, including an increase in the transparency of

108 ibid 15.

109 ibid 16.

110 ibid 16.

111 See Rozanov, 'Definitional Challenges of Dealing with Sovereign Wealth Funds' (n 41) 259; Lauge N Skovgaard Poulsen, 'Investment Treaties and the Globalisation of State Capitalism: Opportunities and Constraints for Host States' in Roberto Echandi and Pierre Sauvé (eds), *Prospects in International Investment Law and Policy* (Cambridge University Press 2013) 85.

112 Epstein and Rose (n 77) 128.

113 Justin O'Brien, 'Mapping the Trajectory of the Regulatory Debate: Securing the National Interest or Justifying Protectionism?' in Renée Fry, Warwick McKibbin and Justin O'Brien (eds), *Sovereign Wealth: The Role of State Capital in the New Financial Order* (Imperial College Press, London 2011) (n 11) 167.

overarching domestic fiscal policy in emerging markets.[114] More importantly, there is the issue of accountability; transparency requirements would incentivise SWF managers to maintain a politically correct 'arm's length' relationship with their government owners, protecting and enhancing the value of their shareholding, while being simultaneously accountable the public.[115] Last but not least, the existence of transparency rules could help calm public concerns and keep protectionist and populist voices at bay—albeit some will still argue that a Western-style 'code of practice' has no purchase in countries where the rule of law does not exist.[116]

### 6. National Security Concerns

A perceived – yet ill-defined − threat to the 'national security' and 'essential security interests' of the host States has been often branded as the prime regulatory concern surrounding the operation of SWFs. The principal assumption underlying such a concern is the conviction that SWFs – being owned by a foreign government – will not behave in the same way as private investors. On the contrary, it is assumed that these governments will use their SWFs to achieve overt and covert political and strategic objectives. This raises 'national security risks and the potential for strategically motivated investments'.[117]

Even assuming there is an element of risk in allowing SWFs to invest in a market, not all security risks are not of the same magnitude. Indeed, the language of 'national security' is often used to describe risks that are quite different in nature and of a very different degree.

First, there are the *stricto sensu* 'national security concerns'. Indeed, investments in certain industries – especially by SWFs and sometimes even by private investors – are by definition security-sensitive. For instance, SWF investments in the defence or defence-related industries would almost universally be perceived as problematic from a national security standpoint. A number of security threats relevant to these industries have been identified, such as facilitating espionage, aiding the military or intelligence

[114] ibid 167.

[115] Yi-chong (n 5) 16.

[116] ibid 16.

[117] Michael H Cognato, 'Understanding China's New Sovereign Wealth Fund' (2009) 19 NRB Analysis 9, 25.

capabilities of a foreign country that is hostile to the recipient country, compromising the security of public or private networks, denying the host government or moving offshore critical technology and key products that are important for essential security instruments, accessing sensitive data etc.[118]

Second, it has been argued that SWF investments in 'strategically important' industries – not necessarily related to national defence – could also constitute a national security threat. Under this line of argumentation, certain industries of prime national economic importance – due to their size or position in the economy – ought to be protected from foreign takeover in general, and by SWFs' takeovers in particular. Traditionally, such a wide conception of national security was often used by developing countries as an interventionist instrument to promote national champions and to advance their development objectives.[119] However, these days, an increasing number of developed countries are following a similar path.[120]

Thirdly, there are the so-called 'strategic concerns' regarding the operation of SWFs that are not related to any specific sector of the economy. For instance, it has been argued that SWFs can be used as vehicles to facilitate sensitive information and technology transfers. Such a development, it is argued, can seriously threaten an economy's international standing and even directly threaten its national security. Indeed, according to Morgan Stanley, for some countries 'assets that promise solid financial returns may not be as interesting as those that embody technology and techniques that cannot easily be 'home grown' or 'imitated'.[121]

Arguably, there are valid reasons for restricting SWFs' investments in defence or defence-related industries. States have traditionally held a tight grip over these sectors and even private investor activity in these sectors is closely monitored. Nonetheless, the argument is weaker for preventing SWFs' investments in 'strategic industries' or for the prevention of information and technology transfers. The consensus – at least amongst

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118 Gordon and Tash (n 70) 14.

119 UNCTAD, *The Protection of National Security in International Investment Agreements* (United Nations, New York and Geneva, 2009) 16.

120 ibid 16.

121 Morgan Stanley, *How Big Could Sovereign Wealth Funds Be in 2015?* (Morgan Stanley Research, 2007) 3.

OECD countries – seems to be that national security should not be used as an excuse to facilitate what in reality are commercial considerations.

Empirically as well, such concerns of a 'strategic' character are exaggerated. Despite some noticeable concentration in strategically important or sensitive sectors[122] – at least in comparison to private investors[123] – international investment by SWFs spreads across a wide range of sectors and industries.[124] Furthermore, there is 'little evidence that, even from the Middle East and so on, people have actually used the SWFs in order to advance any real strategic political objectives'[125] whilst no instances of industrial espionage have been recorded.[126] Indeed, even the most stringent critics can point to no examples where SWFs leveraged their political connections for gain or obtained national security secrets through commercial investment. Thus, it has validly been argued that '[this] threat is more perceived than real'.[127]

## C. Regulatory Responses to the Challenges Posed by SWFs

### 1. Introduction

The source of all the aforementioned regulatory concerns of host States lies in the nearly complete absence of SWFs' regulation by their respective home States. The operations of SWFs are often obscured, with limited to very few regulatory compliance obligations imposed by host countries.[128] The light regulation applicable – or even

122 Miroudot and Ragoussis (n 87) 58.

123 ibid 65–66.

124 Gilson and Milhaupt (n 6) 1345–1369.

125 Jagdish N Bhagwati, *Statement on Sovereign Wealth Funds: Foreign Policy Consequences in an Era of New Money, Hearing Before the Senate Committee in Finance, US Senate, 110th Congress* (2008) 7; see also Hardev Kaur, 'The Financial Savours That Many Love to Distrust' *New Straits Times* (15 February 2008) for a statement of the then managing director of the Kuwait Investment Authority Bader M Al Sa'ad where he argues that the Kuwait Investment Authority has held shares in Daimler Benz since 1969 and in British Petroleum since 1986, but has never sought to use this shareholder status to influence politics; 'Asset-backed insecurity – Sovereign Wealth Funds' Economist (17 January 2008) Briefs where the newspaper points out that 'it is hard to find examples of sovereign wealth funds abusing their power'.

126 Bhagwati (n 125) 7.

127 Gerard Lyons, *Two Hot Topics: Sovereign Wealth Funds and China* (Standared Chartered, 11 April 2008) 5.

128 Julien Chaisse, 'The Regulation of Sovereign Wealth Funds in the European Union' in Karl P Sauvant, Lisa E Sachs and Wouter PF Schmit Jongbloed (eds), *Sovereign Investment: Concerns and Policy Reactions* (Oxford University Press 2012) 467.

sometimes the absence of any regulation − means that they may not be obliged to disclose their holdings completely or in part. The Norwegian SWF is one of the few exceptions to this practice of limited disclosure.[129]

Indeed, SWFs usually lack transparent structures and management processes that are domestically and internationally accountable.[130] They work in an opaque way, publishing neither statistics as to their composition nor their investments and strategies.[131] It is characteristic that even the IMF has had to rely on a collection of estimates by private financial institutions to merely assess the size of these funds.[132]

In that context, SWFs constitute an *alliud* when operating in foreign markets as, not only are they not regulated at home, but they are not even subject to any serious disclosure requirements. That has always been the case but, more recently, when they started making significant investments abroad, these issues came to the forefront.

In the aftermath of the aforementioned controversial investments by SWFs and the public debate regarding the threats they might pose for host States, calls for international or domestic regulation of SWFs' investments became an item of the daily agenda.[133] In Europe, some EU officials[134] and other politicians called for increased transparency requirements related to actual portfolio positions of SWFs, their investments and operations. Others argued that reciprocity ought to be engaged and that SWFs should only be allowed to invest in a recipient country if (private as well as public) enterprises domiciled there would also be permitted to invest freely in the SWF's home state.[135] A

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129 See Chesterman (n 80).

130 Chaisse (n 128) 467

131 ibid 468.

132 Although the IMF collected data on countries' international financial flows, United States Government Accountability Office (GAO) found that only 13 countries separately reported their SWF holdings in public IMF documents. In the absence of official national or international public reporting, much of the available information about the value of holdings of many SWFs is from estimates by private researchers who project funds sizes by adjusting any reported amounts to reflect likely reserve growth and asset market returns; see United States Government Accountability Office, *Sovereign Wealth Funds: Publically available Date on Sizes and Investment for some Funds are Limitied* (GAO-08-946, Volume 11, September 2008).

133 See, eg, Kimmitt (n 35); Peter Thai Larsen, 'Call for SWFs to Agree Code of Conduct' *Financial Times* (23 January 2008); James Surowiecki, 'Sovereign Wealth World' *The New Yorker* (30 November 2007).

134 See, eg, Hildebrand (n 1)

135 For an account of this argument see Gramlich (n 104) 67.

third suggestion argued for compelling SWFs to invest through intermediary asset managers since such an indirect investment philosophy would generate a better risk-return profile[136] and mitigate most risks associated with these entities. Last but not least, others suggested a policy of regulatory minimalism that would simply devoid SWF-held equity of its voting rights, which would later be regained when transferred to other investors.[137] Such a strategy would presumably mitigate the potential conflicts of interest involved in the operation of SWFs without affecting the benefits they bring to capital markets.[138]

Irrespective of the specific regulatory response, there were parallel discussions about a possible multilateral approach to the phenomenon or, at least, a co-ordinated domestic regulatory response. In the end, as is often the case in International Law, we had a fragmented solution with elements of both approaches.

### 2. Host State Regulation of SWFs' Investments

Despite these initial discussions and policy proposals for a 'light' or 'soft law' regulatory approach to the phenomenon and/or a co-ordinated global response, host States were either not appeased or they fell prey to political pressure from domestic constituents. Either way, a series of States amended their domestic laws in order to enhance their control over SWF investment flows.

Consequently, most OECD governments introduced domestic regulation to monitor and/or control the flow of foreign investment. In most occasions, they have used already existing mechanisms, such as investment 'screening committees', [139] in order to establish control over the flow SWF investment, often by expanding their mandate and powers. These mechanisms have the capacity to either block the entry of a foreign investment into the territory of the host State or to limit that entry when it comes to strategic

136 For an account of this argument see ibid 67.

137 See Gilson and Milhaupt (n 6)

138 ibid 10.

139 For a detailed overview accompanied by empirical data of a number of countries implementing some sort of investment 'screening' legislation see United States Government Accountability Office, *Foreign Investment: Laws and Policies Regulating Foreign Investment in 10 Countries* (Highlights of GAO-08-320, a report to the Honorable Richard Shelby, Ranking Member, Committee on Banking, Housing, and Urban Affairs, US Senate, 2008).

economic sectors.[140] They usually involve a case-by-case review of proposed foreign investments in accordance with the economic or social policies of the host States.[141] Often, they ascertain whether purely commercial interests drive a specific investment,[142] a criterion obviously relevant for SWFs. In a nutshell, as will be demonstrated, host States have reserved and enhanced for themselves the right to block or restrict SWF investment *before* their entry into their markets.

#### *(i) European Union and its Member States*

##### (a) The balance of competences between the EU and its Member States

The increasing presence of SWF investments in the EU has also given rise to significant concerns at the EU level. As a preliminary issue, however, the balance of competences between the EU and its Member States as regards the regulation of incoming SWFs' investments needs to be examined. Article 63 TFEU explicitly provides that:

> Within the framework of the provisions set out in this chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.[143]

Further, it is well established under the case-law of the CJEU (formerly ECJ) that direct investment constitutes a sub-category of capital under the Treaty.[144] Therefore, the

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140 Markus Burgstaller, 'Sovereign Wealth Funds and International Investment Law' in Chester Brown and Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (Cambridge University Press 2011) 169; Yi-chong (n 5)16.

141 Ignacio Gomez-Palacio and Peter Muchlinski, 'Admission and Establishment' in Peter Muchlinski, Federico Ortino and Chistoph Schreuer (eds), *Oxford Handbook of International Investment Law* (Oxford University Press 2008) 238.

142 Burgstaller (n 140) 170.

143 Article 63(1), Treaty on the Functioning of the European Union (Consolidated, as amended by the Treaty of Lisbon) OJ C 326, 26 October 2012.

144 See Council Directive 88/361 of 24 June 1988, which – for the purposes of the internal market – defined 'direct investment' in Annex I under Heading I as '1) Establishment and extension of branches or new undertakings belonging solely to the person providing the capital, and the acquisition in full of existing undertakings; 2) Participation in new or existing undertaking with a view to establishing or maintaining lasting economic links; 3) Long-term loans with a view to establishing or maintaining lasting economic links; 4) Reinvestment of profits with a view to maintaining lasting economic links.' In the Explanatory Notes of Annex I, it was further explained that for the purposes of the Directive and Nomenclature annexed thereto, direct investments mean: 'Investments of all kinds by natural persons or commercial, industrial or financial undertakings, and which serve to establish or to maintain lasting and direct links

EU, in terms of both regulation and policy declares that, in principle, all restrictions on the movement of capital between Member States and third countries are prohibited.

Further, and as a consequence, the EU enjoys an exclusive competence over the regulation of capital movements – including FDI – from third countries at least at the pre-establishment stage. As pointed out by the Commission, with regards to market access, 'the Union has exclusive competence to autonomously legislate on FDI, as in the other areas of the common commercial policy, such as the import and export regulation'.[145] Indeed, EU law provides a comprehensive regime to regulate both the establishment and the actions of foreign investors, which ultimately 'covers SWFs in exactly the same way as any other foreign investor.'[146]

Furthermore, after the Lisbon Treaty, the EU acquired an exclusive external competence over investment policy.[147] The difference is that now the EU has the exclusive competence to conclude agreements covering not only pre-establishment access, but also post-establishment protection of foreign investment.[148] In this context,

between the person providing the capital and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity. This concept must therefore be understood in its widest sense.' The EC Treaty as amended by the Amsterdam Treaty substantially reproduced the contents of Article 1 of Directive 88/361 and extended the freedom to capital movements between Member States and third countries. In any case, under the ECJ's case-law, it is well established that the nomenclature annexed to Directive 88/361 'still has the indicative value, for the purposes of defining the notion of capital movements' under the Treaty: see Case C-222/97 *Trummer and Mayer* [1999] ECR I–1661 [20], [21] and, *inter alia*, Case C-483/ *The Commission v France* [2002] ECR I–4781 [36]. As to direct investments, as included in the material scope of application of the freedom of capital movement, see, *inter alia*, Case C-54/99 *Association Eglise de scientologie de Paris and Scientology International Reserves Trust v The Prime Minister* [2000] ECR I–1335 [14]; Case C-483/99 *The Commission v France* [37] . Also, for a pronouncement that Points I and III in the nomenclature set out in Annex I to Directive 88/361, and the explanatory notes appearing in that annex, indicate that direct investment in the form of participation in an undertaking by means of a shareholding or the acquisition of securities on the capital market constitute capital movements within the meaning of Article 73b of the Treaty see Joined Cases C-463/04 and C-464/04 *Federconsumatori and Others v Comune di Milano* [2007] ECR I–10419 [20].

145 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: 'Towards a Comprehensive European International Investment Policy' COM(2010) 343 fn 14; note, however, that Commission Communications to other EU institutions are not legally binding.

146 EU Communication on SWFs (n 50) 6.

147 For a detailed account see Angelos Dimopoulos, *EU Foreign Investment Law* (Oxford University Press 2011).

148 It is, however, disputed whether the EU possesses all the necessary internal competences to be able to exercise its exclusive external competence *vis-à-vis* the post establishment protection of investments. As a matter of EU Law, the EU cannot have an external competence that is not also 'mirrored' internally. For instance, the EU does not have an internal competence over property protection and, as such, it would not be in a position to assume an international obligation to protect the property rights of investors from expropriation post-establishment. For a detailed analysis of these issues see Michail Dekastros, 'The

the gradual unfolding of a common EU investment policy – through the conclusion of EU-wide BITs[149] − has the potential to raise again the question of whether an EU Committee on Foreign Investment should be established.[150]

(b) EU policy towards SWFs

Taking into account the exclusive EU competence over foreign investment, in 2008, the main European Institutions – the Commission, the Council and the European parliament – decided to address the issue of SWFs and come up with an EU approach to the issue. An initial suggestion for the institution of an EU-wide 'screening mechanism' − similar to the one in the US − that would have the capacity to block inwards SWFs investments was considered but ultimately rejected.[151]

Despite that, in February 2008, the Commission presented a communication, titled '*A Common European Approach to Sovereign Wealth Funds*'.[152] Through the 2008 Communication, the Commission sought to avoid legislative actions and it opted instead for soft measures, such as guidelines, accompanied by efforts to increase transparency at the international level.[153] The Commission recommended a common approach premised on five key principles: 1) commitment to an open investment environment; 2) support of multilateral work; 3) use of existing instruments; 4) respect of EC Treaty and other international commitments; and 5) proportionality and transparency. Further, the Commission set out some of the options *vis-à-vis* regulating SWF operations within the EU Common Market.[154] Eventually, the European Council supported the objective of forming a consensus at the international level on a voluntary Code of Conduct for SWFs and defining principles for recipient countries—in line with the EU Communication. In

Impact of the Lisbon Treaty on Investment Treaties Concluded by the EU and its Member-States' (LLM Thesis, University of Cambridge 2011) *esp*. 13–24.

149 See, eg, the recently signed – but not yet ratified – Comprehensive Economic and Trade Agreement, draft available at Foreign Affairs, Trade and Development Canada, 'Consolidated CETA Text'.

150 See *infra* fn 151.

151 Chaisse (n 128) 469; for a similar proposal and its technical aspects that preceded these discussions see Nicolas Veron and Lars Hendrik-Roller, *Safe and Sound: An EU approach to Sovereign Investment* (Bruegel Policy Brief 2008/08, 2008) 7.

152 EU Communication on SWFs (n 50).

153 Chaisse (n 128) 474.

154 EU Communication on SWFs (n 50) 8–11.

this respect, the Council reiterated the EU's 'support for the ongoing work in the International Monetary Fund (IMF) and the OECD.'[155]

Nonetheless, it insisted that governments should be allowed to 'make use of national and EU instruments if necessary' to counter investment not justified for commercial reasons[156]—a possibility also envisaged in the EU Communication.[157] This consensus was – unsurprisingly – partly the result of the inability of Member States to produce a new comprehensive framework at the supranational level.[158] Therefore, it was decided that the EU Member States would be left to rely on the existing rules that allow derogation from the principle of movement of capital in some limited instances.

(c) Residual Member States' competences over SWFs' investments

The aforementioned EU competence over investment flows and the declared in the Treaties free movement of capital are, however, not absolute. Though a fundamental principle of the TFEU, the movement of capital can be regulated in two ways at the European level.[159]

As per Article 64 TFEU, the EU may: 1) 'adopt, by qualified majority, measures on the movement of capital from third countries involving direct investment'; and (2) 'it is not excluded that the Commission can introduce (by a unanimous decision) measures that restrict foreign investments'.[160] The more narrowly these limits are construed, the easier it will be for SWFs to come into the EU market.[161] Thus, Article 64 of the TFEU gives the EU the competence to adopt measures with regards to the establishment of foreign investors in the EU.

Article 65, however, is arguably the most crucial with regards to SWFs' investments. It provides that:

155 Presidency Conclusions, Brussels European Council, 13-14 March 2008, 7652/1/08 REV 1 [36].

156 ibid [36].

157 See EU Communication on SWFs (n 50) 7.

158 Chaisse (n 128) 470; see also Case C-503/99 *The Commission v Belgium* [2002] ECR I–4809 [48]–[52].

159 Safeguard clauses, however, are also contained in Articles 66 and 75 of the TFEU. These concern third countries and are of a temporary nature, only to be applied in exceptional circumstances such as terrorism or threats to the operation of EMU.

160 Article 64 TFEU.

161 Chaisse (n 128) 484.

> The provisions of Article 63 shall be without prejudice to the right of Member States: [...] (b): to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, *or to take measures which are justified on grounds of public policy or public security*.[162]

Thus, this provision enables Member States to restrict the movement of capital to or from other Member States *or third countries* – as upheld by the ECJ in *Sanz de Lera* and others[163] − when given grounds as a matter of ensuring public order or public security.[164] Notably, the CJEU has held that whenever a Member State is invoking the justification measures of Article 65 TFEU, the country must demonstrate that the means that it used do not go beyond what is necessary to attain the stated end—in essence introducing a proportionality test.[165] Also, the Treaty provides that any such measures shall also 'not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 63'.[166]

Indeed, even before investment explicitly came under the purview of Article 63 TFEU – ie, before the Treaty of Amsterdam − many European States had traditionally been much more apprehensive towards FDI in general in order to protect their 'national champions' or in the name of their (often ill-defined) security interests either by maintaining a preventive 'veto' power over investment flows or an *ex post facto* monitoring of the relevant investment.[167] In that context, even before the advent of SWF investments, they had already set up 'screening mechanisms' that could restrict FDI flows at will.

The EU had not been very content with these developments and, as it gradually solidified its competence over investment flows, some of these measures were

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162 Article 65(1)(b) TFEU (emphasis added).

163 See Joined Cases C-163/94, C-165/94 & C-250/94 *Criminal proceedings against Lucas Emilio Sanz de Lera, Raimundo Díaz Jiménez and Figen Kapanoglu* [1995] ECR I–4821.

164 Article 65(1)(b) TFEU.

165 Chaisse (n 128) 486.

166 Article 65(3) TFEU.

167 Bassan (n 55) 64.

challenged in the context of the 'golden share' case law.[168] In these cases, the legality of 'golden shares' was considered under Article 65(1)(a) TFEU on the free circulation of capital that, as mentioned, only allows derogations from this freedom on grounds of public order and public security. The scope of these exceptions was interpreted as including 'real and serious threats to an essential interest of the community',[169] 'imperative reasons of public interest'[170] and 'energy services security'.[171] It was also decided that these measures can only apply to the extent that they are proportionate and, thus, not all preventive authorisations to the purchase of shares in a company would be allowed;[172] conversely an *ex post* intervention would be more tolerated.[173] As a result, some variations of the domestic laws introducing 'golden shares' were found to be unlawful under EU law.

It seems, thus, that the EU has adopted a more liberal approach to foreign investment – including SWFs – especially when it comes to preventive monitoring mechanisms.[174] These measures have to be strictly defined and be proportionate in

168 Golden shares emerged in the beginning of 1980s in Great Britain – and later introduced by several EU States − and their main objective was the protection of a State's strategic interests by maintaining special rights in privatised companies. The idea behind their introduction was that some privatised companies have a special importance with regards to issues of public policy and national security. Thus, golden shares were a mechanism to safeguard these interests and protect companies against 'undesirable' influence or takeovers. To attain that goal, golden shares confer various special rights such as rights to appoint company directors or members of the Board, rights to veto and decision rights in the general meetings, rights to influence fundamental company decisions (eg, dissolution, mergers, takeovers etc), rights to influence and restrict acquisition of shareholding of the company in questions and others. For more see Frank S Benyon, *Direct Investment, National Champions and EU Treaty Freedoms: From Maastricht to Lisbon* (Hart Publishing, Oxford and Portland, Modern Studies in European Law 2010).

169 See Case C-463/00 *The Commission v Spain* [2003] ECR I–4581, item 72.

170 See Case C-174/04 *The Commission v Italy* [2005] ECR I–4933 [35]; See also Case C-367/98 *The Commission v Portugal* [2002] ECR I–4731 [49]; Case C-483/99 *The Commission v France* [2002] ECR I–4781 [45]; Case C-503/99 *The Commission v Belgium* (n 158) [45]; Joined cases C-282/04 and C-283/04 *The Commission v The Netherlands* [2006] ECR I–9141 [32].

171 Case C-503/99 *The Commission v Belgium* (n 158) [48]; Case C-483/99 *The Commission v France* (n 144) [47]; Case C-463/00 *The Commission v Spain* (n169) [71].

172 See Case *C-483/99 The Commission v France* (n 170) where an *ex ante* authorisation scheme to purchases of securities corresponding to only 10% of the total capitalisation was rejected; see also Case C-463/00 *The Commission v Spain* (n 169) [84]; see also Joined cases C-515/99, C-519/99 to C-524/99 and C-526/99 to C-540/99 *Hans Reisch and Others v Bürgermeister der Landeshauptstadt Salzburg and Grundverkehrsbeauftragter des Landes Salzburg and Anton Lassacher and Others v Grundverkehrsbeauftragter des Landes Salzburg and Grundverkehrslandeskommission des Landes Salzburg* ECR [2002] ECR I–2157.

173 Case C-503/99 *The Commission v Belgium* (n 158) [48]–[52] where the measure was considered to be consistent with the Treaty partly because it was 'subsequent and not preventive' to the resolution.

174 See EU Communication on SWFs (n 50) 7.

nature, although, it has to be noted that in the case of SWFs, several legitimate interests like security, plurality of mass media and prudence will have to be taken into account.[175]

The EU Member States have supposedly modified their legislation to take into account the aforementioned case-law which only allows for the restrictions on the movement of capital when the 'state's vital interest' is threatened. However, they have tended to expand the meaning of the term in order to bypass these limitations—especially after the advent of SWFs. In the following subsections, the relevant screening mechanisms that have been instituted in different Member States to deal with foreign investment flows in general, and SWF investments in particular, will be presented.

#### (d) France

In France (despite having been condemned by the CJEU), the Ministry of Economy must provide a prior authorisation to a transaction falling within 11 'critical' sectors of the economy provided it is satisfied that there are no concerns over the effect of the investment on public order, public safety or national defence.[176] Nevertheless – and despite the fact that this decree has attracted significant attention – its use in practice has been very limited.[177]

Additionally, in one of the most unusual regulatory responses to SWF investments yet, France enacted domestic legislation in November 2008 setting up a special purpose SWF called FSI (*Fond Stratégique d' Investissement*) that will act as a 'white knight' and block foreign government-controlled entities from acquiring stakes in French corporations.[178]

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175 ibid 7.

176 Law 2004-1343 and Enforcement Decree No 1739 of 2005; the eleven critical sectors of the economy are gambling, public security, research, development, production of hazardous substances capable of being used as pathogenic or toxic agents, wiretapping systems, IT security, dual use (civil and military) tools and technology, encryption products and services, national defence and security, research manufacturing and trade of weapons and ammunitions for military action or warfare materials. This legislation is being investigated by the Commission to verify its compatibility with the free circulation of capital and freedom of establishment while the Commission has indicated already that the prior authorisation procedure is disproportionate to its end.

177 Mark Thatcher, *National Policies towards Sovereign Wealth Funds in Europe: A Comparison of France, Germany and Italy* (Policy Briefs, The London School of Economics and Political Science, London, UK, 2013) 4.

178 Efraim Chalamish, 'Protectionism and Sovereign Investment Post Global Recession' (OECD Global Forum on International Investment, Geneva, 6−8 November 2002) 5.

### (e) Germany

In Germany, the rise of SWFs initiated a public debate that started in the summer of 2007. The acquisition of a three per cent stake in the European aircraft producer EADS by Dubai International Capital in July 2007 and rumours that the German companies Siemens AG and Deutsche Bahn AG could be targets of SWFs further fuelled an already negative public sentiment against SWFs.[179] The debate was also stimulated by Josef Ackermann, the CEO of Deutsche Bank, who claimed in June 2007 that Germany needs protection against SWFs from Russia, China, Kuwait, and Dubai.[180] Several other public officials – including Chancellor Merkel – espoused these fears, namely that SWFs could be used for politically motivated investments in sensitive sectors.[181]

In that context, the relevant legislation was revised in 2009, after a series of proposals were examined.[182] It now provides that all foreign investors wishing to purchase more than 25 per cent of a German company have to provide notice in that regard on a voluntary basis; if they do not, a committee composed of the Minsters of Economy, Finance, Foreign Affairs and Interior will start an inquiry which can result in the approval, cancellation or conditional approval of the investment.[183] The review is based on considerations of public order and security, as have been allegedly defined by the ECJ,[184] although, in practice the scope of its meaning is likely to be widened to include considerations of energy supplies, telecommunication networks and strategic public services.[185]

179 Thomas Jost, 'Sovereign Wealth Funds and the German Policy Reaction' in Karl P Sauvant, Lisa E Sachs and Wouter P F Schmit Jongbloed (eds), *Sovereign Investment: Concerns and Policy Reactions* (Oxford University Press 2012) 453.

180 ibid 453.

181 ibid 453.

182 ibid 457–458.

183 See Article 2.2 (1), Thirteenth Act amending the Foreign Trade and Payments Act and the Foreign Trade and Payments Regulation.

184 See Federal Ministry of Economics and Technology, 'Frequently Asked Questions About the Government's Draft Legislation of August 29, 2008 Concerning the Acquisition of German Enterprises by Foreign Investors' 1.

185 Bassan (n 55) 70.

### (f) Italy

In Italy, after a lengthy debate, which commenced in 2008,[186] legislation was introduced in 2012 that modified state powers concerning equity investments in selected sectors.[187] The new legislation provides that – in the defence sector – the government can block the acquisitions of shares, as well as company decisions, or impose conditions on matters such as security of supply or exports of information and transfer of technology, if they identify a 'serious threat' to defence and security. Furthermore, in certain other strategic industries – energy, transport and telecommunications – the government can block or impose conditions on non-EU buyers of shares in 'exceptional cases of risk' to the security and functioning of networks and continuity of supply, as well as block certain company decisions.

### (g) United Kingdom

The United Kingdom maintains a very liberal investment regime in general but also perceives SWF investment as an issue of economic governance and not security.[188] Indeed, all the previous Labour and Conservative governments have rejected new legal controls based on overseas state ownership.[189] On the contrary, legal controls over mergers and takeovers were reduced under the 2002 Enterprise Act. Previously, ministers could refer a merger or takeover to an independent regulatory agency, the Monopolies and Mergers Commission (MMC, now called the Competition Commission); if the Commission was of the opinion that the transaction under investigation was 'against the public interest', then ministers could block it.[190] However, the 2002 Act reduced this power to much narrower grounds—notably only to potential threats to national security, media pluralism or financial stability.[191]

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186 Thatcher (n 177) 8.

187 Decreto legge 15 marzo 2012 no. 21, convertito, con modificazioni, nella legge 11 maggio 2012 no. 56.

188 Mark Thatcher, *Western Policies towards Sovereign Wealth Funds Equity Investments: A Comparison of the UK, the EU and the US* (Policy Briefs, The London School of Economics and Political Science, London, UK, 2012) 3.

189 ibid 3.

190 ibid 3.

191 ibid 3.

(h) Conclusion

It seems therefore that, despite the EU's best efforts, Member States seem to be willing to maintain a significant degree of regulatory control over incoming investment flows. In that context, it would only be natural to assume that the application of these measures in the light of SWF investment will be even more stringent. In fact, there are already hints that the governmental ownership of SWFs will be a determining factor in deciding whether to allow them to invest—at least for some EU countries.

For instance, the United Kingdom, while noting that the ownership of the bidder makes no difference in the way the bid is considered, has stated that government ownership might affect the UK's assessment of whether or not a bid raises public interest concerns. In particular, it could trigger concerns about whether the investor is influenced to behave in a non-commercial manner in pursuit of political objectives.[192] Similarly, Germany has declared that the ownership of the foreign investment company (State or private) and its strategic interests will be taken into consideration.[193]

This expansion of the mandate of preventative 'screening mechanisms' as a response to the rise of SWFs' investments seems to be at odds with the expressed will of the EU about how to address the issue. Nonetheless, the EU has not yet shown any signs of asserting its competences on the matter or of challenging these developments at the CJEU. Admittedly, and despite the dubious legality of these mechanisms, the issue remains sensitive at the moment. As the EU fully develops its exclusive external competence over investment flows, however, the validity of these mechanisms is likely to be challenged.

*(ii) United States of America*

The US has traditionally maintained a certain degree of control over any type of foreign investment.[194] For instance, the International Banking Act of 1978 stipulates that, with some exceptions no foreign bank may establish a branch or an agency or acquire ownership or control of a commercial lending company without the prior approval of the Federal Reserve Board ('FRB'). The FRB will only approve such a request if it

192 Gordon and Tash (n 70) 19.

193 ibid 19.

194 Note, however, that the US – like other countries Members of the WTO – have subsequently agreed to some liberalisation of investment through the GATS and BITs, an issue to which we come to later.

determines that the foreign bank is subject to comprehensive supervision of regulation on a consolidated basis by the appropriate authorities in its home country.[195] Further, there are federal laws with provisions that specifically limit foreign ownership (including from SWFs) in a number of sectors, such as transportation, communications, natural resources, energy, banking and agriculture.[196] Generally federal laws do not restrict foreign investment but place some reporting requirements on foreign investments, including the regulation of FDI in certain sectors, the requirement of prior approval of foreign investment or the restriction of foreign activities of the foreign-owned firm once an investment has been made.[197] Moreover, there are state-level restrictions on foreign investment, most of them being in the insurance and real estate sectors. Many state laws ban a foreign insurer that is owned or controlled in any manner or degree by any government or governmental agency from transacting insurance.[198] Other state laws specifically prohibit foreign ownership of certain types of land, such as agricultural land.[199]

More importantly, however, in 1975, President Ford issued Executive Order 11858 establishing the Committee on Foreign Investment in the United States ('CFIUS') in order to monitor and evaluate the impact of foreign investment in the USA and make sure that the promotion of foreign investment is in consistency with the goal of protecting national security.[200] The Order authorises CFIUS to undertake an investigation of any transaction that might threaten or impair the national security of the USA and send a report to the President. If CFIUS finds that a covered transaction presents national security risks, then CFIUS may enter into an agreement with it, impose conditions on the parties in order to mitigate such risks, or may refer the case to the President for action. When CFIUS has completed all action with respect to a covered

195 Federal Deposit Insurance Corporation, International Banking Act of 1978.

196 Gawdat Bahgat, 'The USA's Policy on Sovereign Wealth Funds' Investments' in Xu Yi-chong and Gawdat Bahgat (eds), *The Political Economy of Sovereign Wealth Funds* (Palgrave Macmillan 2010) 237–240.

197 ibid 240.

198 ibid 240.

199 ibid 240.

200 Executive Order 11858 – Foreing Investment in the United States.

transaction or the President has announced a decision not to exercise his authority then the parties receive a 'safe harbour' with respect to that transaction.[201]

This already restrictive framework was further strengthened, partly as a response to the phenomenon on SWFs. The Congress, on 24 October 2007, enacted the Foreign Investment and National Security Act ('FINSA') to supplement already existing regulation on the screening of foreign investment.[202] Under the Act, foreign investors are now prohibited from acquiring any stakes in defence companies or companies that handle sensitive technology.[203]

Furthermore, the amendment extended the monitoring mandate of CFIUS to include transactions below the threshold of 10% of capital stock—now also bringing portfolio investment into its ambit.

The Act defines covered transactions as any merger, acquisition or takeover that is proposed or pending by or with any foreign person that could result in foreign control of any person engaged in interstate commerce in the USA. The definition of 'control' however, is quite broad since it looks at the 'functional abilities' of an acquirer to exercise control.[204] The regulations provide that there is no control when voting securities are held 'solely for the purpose of investment', which is albeit defined in a circular fashion to mean that the acquirer 'has no intention of directing the basic business decisions of the issuer'.[205] Obviously, this is something that can hardly be assessed ahead of an investment rendering the scheme quite opaque and offering CFIUS a very wide margin of discretion.

Moreover, two more evaluation criteria were added to the already existing ones: an evaluation of whether: 1) the transaction concerns strategic infrastructure; 2) the transaction is made by parties controlled, even if only indirectly, by foreign states.[206]

201 United States Department of Treasury, 'CFIUS Process Overview' (*http://www.treasury.gov/resource-center/international/Pages/Committee-on-Foreign-Investment-in-US.aspx*) accessed 15 October 2015.

202 Foreign Investment and National Security Act of 2007, PL 110-49, 121 Stat 246 which amends the 'Omnibus Trade and Competitiveness Act', already an amendment to the 'Exxon Florio' amendment which established the Committee on Foreign Investment in the United States (CFIUS).

203 See ibid.

204 Money and Finance, 31 Code of Federal Regulations, Appendix to Part 800 – Preamble on Mergers Acquisitions, and Takeovers by Foreign Persons [800.702].

205 ibid [800.219].

206 Namely, the existence of credible evidence that the transaction might threaten the national security and lack of rules that allows coping with that threat adequately and appropriately.

This is important, since for the first time in a piece of legislation of this kind a direct reference to state-controlled entities such as SWFs is made.

Moreover, the President of the United States has the competence to bar any foreign investment on national security grounds, a condition that is left purposefully ill-defined in the Act.[207] In determining the effects of a foreign acquisition on national security, the President may consider the following factors: i) domestic production needed for projected national defence requirements; ii) the capacity of domestic industries to meet national defence requirements, including the availability of human resources, products, technology, materials and other supplies; iii) the control of domestic industries and commercial activity by foreign citizens as it affect the capability and capacity of the USA to meet the requirements of national security; iv) the potential effects of the transaction on the sales of military goods, equipment or technology to a country that supports terrorism or proliferates missile technology or chemical or biological weapons; and v) the potential effects if the transaction on US technological leadership in areas affecting US National Security.[208]

This Act is probably one of the most restrictive in existence since it not only maintains a preventive screening and control mechanism over any investment in the United States, but it also *de jure* imposes more stringent conditions on sovereign investors. Furthermore, the Act purposefully chooses a very widely constructed conceptualisation of 'national security' in order not to curtail the President's broad authority to protect the national security'.[209] Thus, such a definition could encompass commercial considerations or used to protect domestic industries. Despite this, the provision concerning SWFs has been criticised as not being restrictive enough since it is allegedly mainly concerned with national security considerations and does not take into account risks related to economic security.[210] As a response to that criticism, in

207 An indicative list of factors to be considered includes domestic production needs for projected national defence requirements, capability and capacity of domestic industries to meet national defence requirements, control of domestic industries and commercial activity by foreign citizens as long as it affects the capability and capacity of the United States to meet national security requirements.

208 Section 721 of the Defence Production Act of 1050, 50 USC App 2170.

209 See 31 CFR (n 204).

210 See Truman, *Sovereign Wealth Fund Acquisitions and Other Foreign Government Investments in the United States: Assessing the Economic and National Security Implications*.

September 2007, the House of Representatives adopted a resolution that suggested the imposition of further restrictive measures in respect to SWFs.[211]

*(iii) Canada*

In Canada, the 'Investment Canada Act' applies to the establishment of a new Canadian business, the direct acquisition of a Canadian business or the acquisition of an interest in or establishment of an entity carrying on all or any of its operations in Canada.[212] This Act, amongst others, deals with the assessment of whether a proposed transaction is 'of net benefit to Canada' and instructs the competent authorities to examine whether the transaction is likely to result in further economic growth and employment opportunities.[213]

Interestingly, in December 2007, the Government introduced special guidelines on the Investment Canada Act[214] to be adhered to by authorities reviewing transactions involving State-owned entities. These guidelines further add that, the Canadian Government, during the screening process of the investment, will further consider whether the sovereign investor conforms to Canadian standards of corporate governance and transparency, as well as the nature and extend of foreign control before authorising the transaction.[215]

In March 2009, the then Government amended the Act to allow Investment Canada to reject a foreign takeover on grounds of 'national security'.[216] Similarly to FINSA, the

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211 See Michael F Martin, *China's Sovereign Wealth Funds* (CRS Report for Congress, Order Code RL34337, 2008 who suggests the imposition of '1) requirements that any SWF interested in investing in the United States publicly release audited financial statements, that follow international accounting standards on a regular basis; 2) restrictions on the percentage of a US company a SWF may own; and 3) restrictions on the type of investment a SWF may make in US companies – alternatives include restricting SWFs from negotiating a seat on the company's board of directors or representation on company's senior management'.

212 Investment Canada Act, RSC 1985, c 28 (1st Supp).

213 ibid 20–22.

214 Issued pursuant to section 38 of the Act, by the Minister responsible for the statute's administration; see 'Investment Canada Act: All Guidelines' (*Industry Canada*) accessed 28 October 2015, available at https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2.

215 See Bassan (n 55) 75.

216 See Bill-C10.

notion of 'national security' is not defined—injecting an already opaque test[217] with further uncertainty.

*(iv) Australia*

In 2009, the Australian government revised and updated its 'Foreign Acquisitions and Takeover Act 1975' which now re-emphasises that '[t]he government determines what is contrary to the national interest' by having regard to the widely held community concerns of Australians'.[218] Obviously, such an open-ended definition could encompass a wide spectrum of factual situations and apply in the case of SWF investment.

*(v) Russia*

Similarly, on 29 April 2009 Russia enacted new legislation, which subjects takeovers of Russian companies in 42 strategic industries, including nuclear energy, natural resources and defence, to prior approval of the State Government Committee.[219] More importantly, foreign States and entities controlled by them are prohibited from acquiring direct or indirect control over strategic enterprises,[220] and prior approval by the State Government Committee is required if foreign States or entities controlled by them acquire more than 25 per cent of the votes represented by the shares in a strategic enterprise or the power to block decisions of the management bodies of such enterprises.[221]

### 3. Multilateral Attempts to Regulate SWFs' Investments

The initial debate about the regulatory challenges surrounding SWFs was followed by a secondary one on whether a multilateral regulatory approach is necessary or at least preferable to fragmented domestic regulatory responses.

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217 See Subrata Bhattacharjee, 'National Security with a Canadian Twist: the Investment Canada Act and the New National Security Review Test' (2009) 1 Transnational Corporations Review 12; Edward Safarian, 'The Canadian Policy Response to Sovereign Direct Investment' in Karl P Sauvant, Lisa E Sachs and Wouter P F Schmit Jongbloed (eds), *Sovereign Investment: Concerns and Policy Reactions* (Oxford University Press 2012).

218 Australian Government Treasury, *Australia's Foreign Investment Policy* (2015), 1.

219 Procedures for Foreign Investment in Companies Which Are of Strategic Importantance for Ensuring the Country's Defence and National Security, Federal Law No. 57-FZ, Rossiyskaya Gazeta, 7 May 2008.

220 ibid, Article 2(2).

221 ibid, Article 2(3).

The main argument in favour of the international regulation of SWFs was based on the premise that they have a legitimate role to play in the recycling of global financial imbalances—a pattern of large, persistent currency account deficits in the USA and, to a lesser extent, in Britain and other rich countries, matched by surpluses in oil-exporting countries and Asian developing economies.[222] The global imbalance was, therefore, the root and consequence of these SWFs as 'the world has moved robustly toward liberalisation of both trade and capital flows while governments have asserted a historically unprecedented sovereign right, and indeed responsibility, to control the supply and price of national money.[223] Indeed, pursuant to this reasoning, if SWFs were the by-products of a global financial imbalance, then any concerns about them would also be global.

In that context, several proposals about what would be the appropriate forum to deal with the global regulation of SWFs were voiced. Both the OECD and the IMF had been suggested as the proper places to deal with the issue.[224] Some even argued that the WTO should be the place where the SWF-holding countries and the targeted countries could strike a bargain without having to fundamentally reform the existing multilateral institutions or even the rules.[225]

At the G-7 Finance ministers meeting in October 2007, ministers discussed SWFs for the first time and agreed on a *communiqué*. According to it, the IMF, World Bank and OECD should explore best practices for SWFs in key areas such as institutional structure, risk management, transparency and accountability. The International Working Group that was set up was assisted by the IMF and acknowledged that SWFs have been playing a positive and 'shock-absorbing' role in international financial markets. The 26 members acknowledged than new rules were needed so that they would not be

222 Yi-chong (n 60) 251; in that context, the main reason for the creation of these SWFs was the diversification and more active management of foreign exchange reserves with a view towards maximizing risk-adjusted returns rather than preparing for shortages of international liquidity, see ibid 258.

223 Benn Steil and Manuel Hinds, *Money, Markets & Sovereignty* (Yale University Press, New Haven 2009) 9.

224 Gramlich (n 104) 60–62.

225 See Aaditya Mattoo and Arvind Subramanian, 'Currency Undervaluation and Sovereign Wealth Funds: A New Role for the World Trade Organization' (2009) 32 The World Economy 1135.

discriminated against and, in return, they would guarantee national security and financial stability of the recipient countries.[226]

Ultimately, and as a result of these discussions, a more informal approach was chosen as the appropriate form of action that would not be accompanied by any hard rules—at least at the international plane. As a result the IWG adopted the Generally Accepted Principles and Policies (‘GAPP’), also known as ‘Santiago Principles’ in October 2008 by consensus. The Santiago Principles are explicitly defined as a voluntary set of practices “that the members of the IWG support and either have implemented or aspire to implement.”[227] The Santiago Principles highlight four objectives of SWFs: 1) to help maintain a stable global financial system and free flow of capital and investment; 2) to comply with all applicable regulatory and disclosure elements in the countries in which they invest; 3) to invest on the basis of economic and financial risk and return-related considerations; and 4) to have in place a transparent and sound governance structure that provides for adequate operational controls, risk management and accountability.[228] By accepting these principles, members of the IWG have committed to make a series of specific public disclosures, including information to the IMF and OECD in particular. In April 2009, the IWG also announced the creation of the International Forum of SWFs where they can exchange information about their investment strategies and operations and, more importantly, the changing policies of recipient countries.

SWFs reacted positively positive to this development and they gradually begun to comply with the Santiago principles. Despite the fact that the Principles are non-binding, compliance with the code of conduct has been estimated at about sixty per cent.[229]

Nevertheless, in the aftermath of the 2008−2010 crisis, ‘SWFs were (legitimately) “puzzled that the standards and transparency requirements that others advocate for them

226 Yi-chong (n 5) 18.

227 IWG ‘Santiago Principles’ (n 47) 5.

228 ibid 4.

229 Afshin Mehrpouya, Chaoni Huang and Timothy Barnett, *An Analysis of Proxy Voting and Engagement Policies and Practices of the Sovereign Wealth Funds* (IRRCi SWF Report prepared by RiskMetrics Group Inc, October 2009), available at http://irrcinstitute.org/wp-content/uploads/2015/09/Sovereign_Wealth_Funds_Report-October_20091.pdf >, 13–14.

go far beyond anything that has been envisaged for the highly leveraged hedge funds and private equity communities in industrial countries"'.[230]

## D. INTERIM CONCLUSION

In conclusion, SWFs have gradually become a very important player in the field of investment in services and it is likely that their rise is nothing but fleeting. In that context, their operation in foreign markets has drawn attention to regulatory issues that concern their operation.

However, these risks should probably not be overemphasised. Indeed, SWFs are economic entities of a hybrid nature but their public policy objectives can only be successfully met when they operate most efficiently within the market. In that sense, they are not too different to any other market actor and their presence can be very beneficial to the global economy. Indeed, SWFs have a lot in common with any other private investor; many of the aforementioned regulatory concerns can also be encountered in the operation of private entities – such as hedge or private equity funds – and host States have a legitimate role to play in regulating the operation of all these economic entities.

Nonetheless, there are some valid regulatory concerns that are indispensably linked to the 'government ownership' of SWFs—the characteristic that sets them apart from all other private investors. The issues that flow from their government ownership though are limited to only certain types of non-commercial objectives that they might be tempted to pursue, the lack of transparency surrounding their operations and corporate governance structures and, in some instances, national security.

In that context, a successful regulatory strategy towards SWFs would need to prevent legitimate concerns from turning into 'illegitimate hysteria'.[231] Arguably, SWFs

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230 Rolando Avendano and Javier Santiso, *Are Sovereign Wealth Funds' Investments Politically Biased? A Comparison with Mutual Funds* (OECD Development Centre, Working Paper No 283, DEV/DOC(2009)8, 2009) 9.

231 See Gawdat Bahgat, 'Sovereign Wealth Funds: Danger and Opportunities' (2008) 84 International Affairs 1189.

are already hesitant to invest after the financial crisis,[232] and, thus, overly burdensome regulation should not serve as an additional disincentive.[233]

Therefore, it is submitted, that any sort of regulation ought to be focusing into developing domestic rules that will deal only with these narrow concerns. The answer ought not to be an attempt to purge the sovereign involvement, or to force sovereign commercial entities into a pure-market straitjacket. It is to identify where rules are needed and are likely to be beneficial, and where they are not. Under such an understanding, political and commercial objectives of SWFs 'exist in a continuum, with a substantial "grey zone" between the two extremes of pure commercial motives and unacceptable political motives'.[234] Nonetheless, only marginal cases where an investment is exclusively or primarily motivated by 'political' or 'geopolitical' considerations should be prevented from operating within a domestic market.[235] For instance, SWF investment in defence or defence-related industries would carry such characteristics.

Nonetheless, the current regulatory approaches pursued by host States do not seem to conform to this analysis. Admittedly, domestic legislation long before the advent of SWFs has recognised that general risks to 'public policy or national security' exist and, as a response, has established foreign control regimes that typically extend to all foreign acquisitions of substantial shareholdings irrespective of the identity of the acquirer.[236] However, recipient States of SWFs' investments have enhanced the discretion of monitoring committees and mechanisms to restrict or to block SWF investments.

The rationale behind these developments seems to be that, when dealing with SWFs, it is preferable to determine whether their investment should go ahead *in abstracto* and *before* their entry into the relevant market, rather than focusing specifically on any of these legitimate regulatory concerns. The regulators, however, have opted for an

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232 See Clare O'Brien, Tania Mattei and Thomas Naveen, 'Sovereign Wealth Funds: Evolving Perceptions and Strategies' *Bloomberg BNA* (24 December 2012) Securities Regulation & Law Report.

233 Sandor (n 65) 977.

234 Gordon and Tash (n 70) 9.

235 For the term 'geopolitical' and its use in that context see Rozanov, 'Definitional Challenges of Dealing with Sovereign Wealth Funds' 263 who attempts to describe a narrower sub-category of non-commercial considerations albeit admitting that it is challenge to introduce a universally accepted definition of such a nebulous concept.

236 Schweitzer (n 4) 87.

approach that injects too much uncertainty into the review process and entrusts the reviewing authority with almost unfettered regulatory discretion.[237] Indeed, crucial concepts for that determination, such as 'control' and 'national security' are either ill-defined or not defined at all in the relevant instruments.

As a result, such mechanisms, in applying opaque and subjective standards, allow the possibility of populism to infiltrate the review processes 'under the guise of the national security rubric'[238] especially since 'national security' is such an amorphous concept that can be invoked with ease in many different contexts.[239] This is especially true in the case of SWFs since their defining characteristic – foreign government ownership – makes them a prime target of political controversy and populism. The combination of these factors that could lead to discriminatory or arbitrary governmental, regulatory or administrative treatment motivated by domestic political considerations.[240] Such 'financial protectionism, however, would clearly be to the detriment of global economic welfare';[241] opaque regulatory systems deter investment because risks become hard to quantify[242] and that could in turn could lead to investment 'chill' and raises in the cost of capital.

Therefore, it is submitted that there is an unacceptable degree of flexibility in the proposals emanating from Brussels, Washington, and other EU capitals, since each maintains political discretion over ill-defined 'strategic interests'.[243] Such an approach is problematic – at the very least from a policy perspective – since it is not focusing on the

237 Paul Rose, 'Sovereigns as Shareholders' (2008) 87 North Carolina Law Review 83, 130–137; see also Robert W Shearer, 'The Exon-Florio Amendment: Protectionist Legislation Susceptible to Abuse' (1993) 30 Houston Law Review 1729.

238 Julius Melnitzer, 'Cash Rules' Lexpert: The Business Magazine for Lawyers 83, 85 quoting George Addy of Davies Ward Phillips & Vineberg LLP; Mattoo and Subramanian (n 225) 1150.

239 Melnitzer 86 quoting Catherine Pawluch of Gowling Lafleur Henderson LLP; see also Audit (n 3) 618.

240 Blyschak (n 14) 13–14.

241 Beck and Fidora (n 35) 13; see also Theodore H Moran, 'Foreign Acquisitions and National Security: What are Genuine Threats? What are Implausible Worries?' (2013) World Scientific Book Chapters 371.

242 Douglas Rediker, 'Statement on Sovereign Wealth Funds: Do Sovereign Wealth Funds Make the U.S. Economy Stronger or Pose National Security Risks?: Hearing Before the Joint Economic Committee, US Senate, 110th Congress, 13 February 2008.

243 O'Brien (n 113) 167.

real problem, which is how the inevitable grey zone between ‘pure commercial motives and unacceptable political motives’ be demarcated.[244]

In the next Chapter of this thesis, it will be argued that the current regulatory approaches of host States are not merely problematic from a policy perspective. Indeed, and perhaps ironically, host States not that long ago were champions of the free movement of capital and, as a consequence, are parties to several Treaties that crystallise a very liberal regulatory framework with regards to foreign investment. In that context, it will be argued that the enhancement of the competences of foreign investment screening mechanisms – now possessing the competence to restrict or block SWFs’ investment with unfettered discretion – runs afoul of several agreements under the *acquis* of IEL.

244 Gordon and Tash (n 70) 9.

# III. SWFS' INVESTMENTS AND THEIR PRE-ESTABLISHMENT PROTECTION

## A. INTRODUCTION

In this chapter, the disciplines that regulate the pre-establishment stage of SWFs' investments will be explored. As analysed earlier, recipient States of SWFs' investments have been pursuing a regulatory strategy that often attempts to 'screen' them pre-emptively and occasionally block them, when some very widely constructed conditions are met. Monitoring or screening mechanisms were usually already in place but their scope and powers have been often extended, mainly as a response to the phenomenon of SWFs. In that context, the single most important issue concerning SWFs is whether, and to what extent, they enjoy the right to invest in foreign markets without being discriminated against in relation to other foreign and domestic investors.

Admittedly – at least *prima facie* –there is no generally recognised right of individuals to invest in foreign markets or an international standard requiring States to admit inwards FDI without any qualification.[1] However, over the years, there has been a consistent push to allow the free flow of capital across borders. This has resulted in a limited, yet fragmented, international regulatory framework that provides certain pre-establishment rights to some classes of investors. The GATS, FTAs and several BITs have created a space of variable geometry in which a qualified right to invest in some areas and under some circumstances has come to exist.

Consequently, it will be claimed that the use of 'investment screening mechanisms' to restrict SWFs' investments is at odds with and *prima facie* violates both the GATS and some of the relevant FTAs and BITs that extend their protection to the pre-establishment stage. Therefore, it will be argued that the regulatory approach followed by recipient States is unlawful under International Economic Law.

## B. DELINEATING CAPITAL MOVEMENTS, INVESTMENT AND ESTABLISHMENT RIGHTS IN IEL

One of the conceptual difficulties relevant to the regulation of SWFs' investments involves actually defining capital movements, investment and other related concepts such as market access and freedom of establishment. This is very important for the

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1 Jean-Pierre Laviec, *Protection et Promotion des Investissements: Etude de Droit International Économique* (Presses Universitaires de France 1985) 77.

purposes of this thesis since we have to carefully define the limits of binding instruments over investment flows before we examine whether SWFs' investments are actually covered – and to what extent – by them.

Unfortunately, there is no multilateral agreement regulating investment flows between States. For a variety of reasons, investment flows have never been regulated at the international level under a clear set of rules or under the auspices of an international organisation—despite some initial efforts.[2] This problem has been partly accentuated due to the patchwork of binding and non-binding instruments that have been negotiated over the years both at the multilateral and the bilateral level and, admittedly, have been the source of a lot of confusion.

The underlying reason why the regulation of capital movements has been fragmented and obscure is probably that, even to date, there is no consensus on which capital movements are beneficial and on whether States should have the ability to unilaterally regulate them. Over the years, the opinion seems to have been swinging from one direction to the other.

### 1. Distinguishing Capital Movements from Current Transactions

First, as preliminary issue, capital movements have to be distinguished from a similar, but very different concept, that of international current transactions. International current transactions[3] involve the international movement of currency and, under both Article XI:1 GATS[4] and Article VIII of the Agreement on the International Monetary

2 In 1947, the UNCTAD has prepared a draft Charter for a proposed International Trade Organisation ('ITO'), which was presented at the Havana Conference at the end of 1947. The moribund ITO would cover not only trade in goods and services but also include rules on investment and competition. Indeed, ITO Members would undertake the dual obligation to 'provide reasonable opportunities […] and adequate security for existing and future investments' and 'give due regard to the desirability of avoiding discrimination as between foreign investments'; see Articles 12.2 (a) (i) and (ii), The Final Act and Related Documents of the United Nations Conference on Trade and Development, Havana, Cuba, 21 November 1947 – 24 March 1948 (Final Act of the Hanava Conference), included the draft Charter for the International Trade Organisation (ITO), UN Doc, ICITO/1/4 (1948).

3 See Articles of Agreement of the International Monetary Fund, July 22, 1944, 60 Stat 401, 2 UNTS 39, as amended, 11 November 1992, 31 ILM 1307, 1309-10, Article XXX lit. d which defines current transactions as 'any payments that are not for the purpose of transferring capital'; see also Communication from the International Monetary Fund: The Role of the Fund in the Area of Services Under its Articles of Agreement, MTN.GNS/W/91 (10 January 1990) [8] *et seq.*; note, however that the GATS − in contrast − does not contain a definition.

4 General Agreement on Trade in Services, April 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, The Legal Texts: the Results of the Uruguay Round of Multilateral trade Negotiations 284 (1999), 1869 UNTS 183, 33 ILM 1167 (1994), Article XI:1:

Fund ( 'IMF'),[5] they ought to be fully liberalised − assuming specific commitments have been made under the GATS − save for some limited circumstances.[6]

In order to appreciate what is the object of this distinction and why is it so important, we need to understand the context in which these provisions operate. In general, foreign currency is indispensable in managing the balance of payments of a State and maintaining macroeconomic stability; under some circumstances, thus, it is perfectly acceptable for a State to adopt measures that restrict the availability of currency or manipulate its value in order to safeguard monetary stability.[7]

When the GATT was negotiated, however, it became very clear that if trade flows were to be liberalised then currency movements had to be unrestricted so that foreign exchange could be used a means of payment; this principle was later incorporated into the GATS as well.[8] At the time, this did not pose big problems, as there was I place a

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> 1. Except under the circumstances envisaged in Article XII, a Member shall not apply restrictions on international transfers and payments for current transactions relating to its specific commitments.

5 Article VIII, IMF Agreement; for an overview of the issues concerning the regulation of international payments under the IMF Agreement see Hector Elizalde, 'The International Monetary Fund and Current Account Convertibility' in IMF (ed), *Current Developments in Monetary and Financial Law*, vol 4 (2005) 17−53.

6 See Benedict F Christ and Marion Panizzon, 'Article XI GATS Payments and Transfers' in Rüdiger Wolfrum, Peter-Tobias Stoll and Clemens Feinäugle (eds), *Max Planck Commentaries on World Trade Law*, vol 6 (Martinus Nijhoff Publishers, Leiden 2008) 245–257 who identify five circumstances under which the GATS permits deviations from this rule:

> (i) to safeguard the balance of payments in accordance with Art. XII GATS, (ii) in case a general exception applies in accordance with Art. XIV and XIV*bis* GATS, (iii) in case an exception applies in accordance with para. 2 lit. a of the Annex on Financial Services, (iv) in the case of current transactions, if consistent with the rights and obligations of the members of the IMF under the IMF Agreement, or (v), in the case of capital transactions, at the request of the IMF.

On situation (iii), namely the so-called 'prudential carve-out' of the GATS', see the recent *Argentina – Financial Services* Panel Report, Argentina – Measures Relating to Trade in Goods and Services, WT/DS453/R and Add1, circulated to WTO Members 30 September 2015 [appeal in progress] [7.813]–[7.817] which confirmed that para. 2 lit. a of the Annex on Financial Services constitutes an 'exception' to the other provision of the GATS and not a provision which renders the rest of the agreement 'inapplicable'; for more on this issue see Carlo Maria Cantore, '"Shelter from the Storm": Exploring the Scope of Application and Legal Function of the GATS Prudential Carve-Out' (2014) 48 Journal of World Trade 1223.

7 See Rosa María Lastra, *Legal Foundations of International Monetary Stability* (Oxford University Press 2001) 34–39.

8 See Article XI (1) GATS which provides that:

multilateral regime that regulated currency movements.[9] However, when the fixed exchange rate regime that was established by the IMF collapsed after the 'Nixon shock', foreign currency became a capital asset on its own right.[10] This resulted in a blurring of the lines between capital movements and international payments. Furthermore, in the few instances where these issues have been raised in front of an adjudicatory body, no solution was given—in fact, the issue was disregarded. Namely, in the *US – Gambling* case, Antigua argued that some of the restrictions imposed by the United States on gambling services resulted in a restriction of international payments, as scheduled in the GATS commitments.[11] The Panel did not rule on this claim though and the IMF itself

> Except under the circumstances envisaged in Article XII, a Member shall not apply restrictions on international transfers and payments for current transactions relating to its specific commitments.

9 See also Article XV(2) GATT which provides that:

> In all cases in which the CONTRACTING PARTIES are called upon to consider or deal with problems concerning monetary reserves, balances of payments or foreign exchange arrangements, *they shall consult fully with the International Monetary Fund*. In such consultations, the CONTRACTING PARTIES *shall accept all findings* of statistical and other facts presented by the Fund relating to foreign exchange, monetary reserves and balances of payments, and *shall accept the determination of the Fund as to whether action by a contracting party in exchange matters is in accordance with the Articles of Agreement of the International Monetary Fund, or with the terms of a special exchange agreement between that contracting party and the CONTRACTING PARTIES*. The CONTRACTING PARTIES in reaching their final decision in cases involving the criteria set forth in paragraph 2 (a) of Article XII or in paragraph 9 of Article XVIII, shall accept the determination of the Fund as to what constitutes a serious decline in the contracting party's monetary reserves, a very low level of its monetary reserves or a reasonable rate of increase in its monetary reserves, and as to the financial aspects of other matters covered in consultation in such cases (emphasis added).

See however *India – Quantitative Restrictions* Panel Report, India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products, WT/DS90/R, adopted 22 September 1999, upheld by Appellate Body Report WT/DS90/AB/R, DSR 1999:V, 1799 [5.12]–[5.13] where the Panel – when the issue of the relationship between the WTO and the IMF was raised – did not resolve whether it was required to consult the Fund but noted that it had authority under the Dispute Settlement Understanding (Art. 13) to 'seek information and technical advice from any individual or body which it deems appropriate'. This result is troubling since a future panel could choose not to consult the Fund or to accept its findings in accordance with Article XV:2; for more on the relationship between the IMF and the GATT/WTO see Deborah E Siegel, 'Legal Aspects of the IMF/WTO Relationship: The Fund's Articles of Agreement and the WTO Agreements' (2002) 96 American Journal of International Law 561.

10 Federico Lupo Pasini, 'Movement of Capital and Trade in Services: Distinguishing Myth from Reality Regarding the GATS and the Liberalization of the Capital Account' (2012) 15 Journal of International Economic Law 581, 587.

11 *US – Measures Affecting the Cross-Border Supply of Gambling and Betting Services* WTO Panel, WT/DS285/R, adopted 20 April 2005, as modified by Appellate Body Report WT/DS285/AB/R, DSR 2005:XII, 5797 [6.438].

did not offer any additional clarification other than a vague reference to an Executive Board decision dating from 1960.[12] Therefore, the principle that States have complete discretion over the regulation of capital movements whilst international current payments are to be liberalised became increasingly more difficult to defend since distinguishing between the two would involve ascertaining *a priori* the purpose of any given transaction.[13]

Allowing the complete free flow of capital can greatly diminish the regulatory space of a State over its economy; namely, setting an interest rate, controlling the value of the national currency and maintaining macroeconomic stability becomes on some occasions much more arduous.[14] This is the reason why in practice States use several methods to influence the volume, destination and composition of financial flows[15] in order to serve these macroeconomic goals, with capital controls being the most important and, lately, relevant.[16]

Given this blurring of the lines between capital movements and current payments, it is nowadays disputed whether the imposition of capital controls is unrestricted given the several obligations that States have undertaken under both the GATS and the several BITs and which impose some obligations on the freedom of capital movements *per se*. Nevertheless, in principle, even the removal of barriers on payments related to capital operations would not necessarily mean removal of barriers on the related capital operation itself; a given country might remove all restrictions on current payments, while

12 The decision stated that the guiding principle in ascertaining whether a measure is a restriction on payments and transfers for current transactions under Article VIII, Section 2 is 'whether it involves a direct governmental limitation on the availability or use of exchange as such'; see International Monetary Fund, *Executive Board Decision No 1034-(60/27)* (1 June 1960).

13 Pasini (n 10) 589.

14 See Filiz D Unsal, *Capital Flows and Financial Stability: Monetary Policy and Macroprudential Responses* (IMF Working Papers WP/11/189, 2011); For a general overview on capital account liberalisation see International Monetary Fund, *The IMF's Approach to Capital Account Liberalization* (IMF, 2005).

15 For a detailed discussion about managing capital flows see Jonathan D Ostry and others, *Managing Capital Flows: What Tools to Use* (IMF Staff Discussion Note SDN/11/06, 2011).

16 Capital controls can generally be defined as regulatory barriers to the movement of capital motivated by the origin or destination of the capital or of the nationality of the investor; see Pasini (n 10) 590.

it might still in principle maintain some degree of control on the admission of foreign capital movements.[17]

### 2. Distinguishing Investment from Capital Movements

Having demarcated the limits between current transactions and capital movements, we have to continue our endeavour by examining the notion of capital movements. In broad terms, capital movements consist of movements of financial resources across borders through international transactions of real and financial assets between a resident and a non-resident of a particular country.[18] These capital transactions, which include all financial transactions which do not qualify as current payments,[19] can generally take one of the following forms: 1) international investment in debt or equity securities, mutual funds, market derivatives and any other market instruments; 2) international banking transactions such as loans; 3) international direct investment, such as the purchase or sale of real estate or equities; and 4) miscellaneous transactions, such as personal capital movements in cash, donations or legacies.[20]

This highlights that the freedom of movement of capital and the freedom of investment are not quite the same thing, as is sometimes implied. Indeed, there is a number of capital movements that do not qualify as investments, while often overlooked is the fact that a number of investments can be carried out without any movements of capital (eg, the investor could contribute in kind instead of capital).[21]

The first and third aforementioned categories are the most important for the purposes of this thesis since they coincide with the two main categories of investment transactions, namely portfolio and direct investment respectively. As suggested earlier,

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17 France followed a similar policy in 1960s. See 'Décret n°67-78 du 27 Janvier 1967 fixant les modalités d'application de la loi n° 66-1008 du 28 Décembre 1966 relative aux relations financières avec l'étranger' which subjected French direct investments outside France and foreign direct investments within France to preliminary control, though, at that time, no restriction was yet in force with respect to payments related to capital operations, whatever their nature. In other words, at that time France had investment regulation, but no exchange regulation.

18 Peter B Kenen, *The International Economy* (4th edn, Cambridge University Press 2000), 301–327.

19 Patrick Juillard, 'Freedom of Establishment, Freedom of Capital Movements, and Freedom of Investment' (2000) 15 ICSID Review 322, 334.

20 Barry R Johnston and Natalia T Tamirisa, *Why Do Countries Use Capital Controls?* (IMF Working Paper WP/98/181, 1998), 6.

21 Juillard (n 19) 333.

SWFs are engaging in a variety of investment activities but they seem to be moving from portfolio to direct investments.

### 3. The Liberalisation of International Investment Flows

For a long time, foreign investment remained a matter to be strictly regulated under national law.[22] The right of a State to control the entry of an investment into its territory was unlimited, as it was considered to be flowing from its sovereignty.[23] Gradually, however, States started becoming less protective and developed States started pushing for a more liberal approach towards the freedom of investment.

This shy liberalisation trend reflected disagreement amongst economists about whether the free flow of investment had an overall positive or negative effect on the economy. Mainstream economic theory suggested that the free movement of capital benefits the economy since it increases the source of financing, raises the savings rate (thus increasing the potential level of investment), lowers the balance of payments constraint on growth and real interest rates and generally contributes to the development of the economy of the host State.[24] On the other hand, developing States were quite sceptical about the idea, not only due to being defensive about their sovereignty, but also because there was some empirical research suggesting that capital outflows associated with foreign investment might be twice as much as the initial inflows.[25]

The collapse of the Soviet Union, however, altered the geopolitical and ideological *status quo*. Liberal ideas seemed to be gaining a lot of ground and for some time it

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22 Rafael Leal-Arcas, *International Trade and Investment Law: Multilateral, Regional and Bilateral Governance* (Edward Elgar Publishing 2010) 180; for a detailed historical account see also Arghyrios A Fatouros, 'Towards an International Agreement on Foreign Direct Investment?' (1995) 10 ICSID Review 181.

23 James Crawford, *Brownlie's Principles of Public International Law* (Oxford University Press 2012) 608–609; Dominique Carreau and Patrick Juillard, *Droit International Economique* (Dalloz-Sirey 2003) 361; Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment* (Cambridge University Press 2010) 88.

24 James Hodge, 'Liberalization of Trade in Services in Developing Countries' in Bernard Hoekman, Aaditya Mattoo and Philip English (eds), *Development, Trade, and the WTO, A Handbook* (The World Bank, Washington DC 2002) 228; Pasini (n 10) 582; see also Carlos Arteta, Barry Eichengreen and Charles Wyplosz, *When Does Capital Account Liberalization Help More Than It Hurts?* (NBER Working Paper No 8414, 2001); Joshua Aizenman and Brian Pinto, *Managing Financial Integration and Capital Mobility – Policy Lessons from the Past Two Decades* (World Bank Policy Research Working Paper 5786, 2011).

25 See John R Oneal and Frances H Oneal, 'Hegemony, Imperialism, and the Profitability of Foreign Investments' (1988) 42 International Organization 347.

appeared as if there is absolutely no alternative to the liberal open economy model.[26] It is perhaps no coincidence that the WTO agreements and a very significant number of BITs were negotiated and ratified during the 1990s. This liberalising trend continued apace until the end of the 1990s. The Asian Financial crisis and the imposition of capital controls that accompanied it posed the first challenge to this liberal market paradigm. During the 2000s quite a few Latin American countries started to aggressively challenge this paradigm mainly in the natural resources sector (Venezuela, Chile and Bolivia), or as a result of economic emergency measures (Argentina).[27] Similarly, Russia has imposed some sectoral limitations[28] while Thailand has also adopted a more restrictive foreign investment law.[29] In addition to all that, a consensus on whether the existence of BITs actually increased investment in developing countries is absent.[30] Certain empirical studies found little or no impact of BITs on actual investment flows,[31] while others reached the opposite conclusion.[32]

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26 This development already had its origins in the late 1980s when a consensus supporting economic liberalism as a precondition to growth and innovation begun forming. An famous paper by J Williamson provided a list of conditions for successful economic growth, which eventually came to be known as the 'Washington Consensus'; see John Williamson, 'From Reform Agenda to Damaged Brand Name - A Short History of the Washington Consensus and Suggestions for What to Do Next' (2003) 40 Finance and Development 10; see also Dani Rodrik, *One Economics, Many Recipes: Globalization, Institutions, and Economic Growth* (Princeton University Press 2008) 17 who added ten additional items to Williamson's original list, including 'adherence to the WTO disciplines'.

27 UNCTAD, *World Investment Report 2006* (2006) 23–25.

28 See Federal Law on Foreign Investment in the Russian Federation of 9 July 1999, 39 ILM 894 (2000).

29 The Ministry of Commerce Thailand, *The Foreign Business Act Amendment: A Brief Explanation* (2007).

30 Eric A Posner and Alan O Sykes, *Economic Foundations of International Law* (Harvard University Press 2013) 293–294.

31 See Kenneth J Vandevelde, 'The Economics of Bilateral Investment Treaties' (2000) 41 Harvard International Law Journal 469, 498 who concluded that '[t]he evidence is that BITs have been at least marginally successful in increasing investment flows in some cases'; see also Bernard Hoekman and Kamal Saggi, 'Multilateral Disciplines for Investment-related Policies?' in Paolo Guerrieri and Hans-Echart Scharrer (eds), *Global Governance, Regionalism, and the International Economy* (Nomos, Baden-Baden 2000).

32 See Eric Neumayer and Laura Spess, 'Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?' in Karl P Sauvant and Lisa E Sachs (eds), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (Oxford University Press 2009) 225, 248; Peter Egger and Michael Pfaffermayr, 'The Impact of Bilateral Investment Treaties on Foreign Direct Investment' (2004) 32 Journal of Comparative Economics 788; Jeswald W Salacuse and Nicholas P Sullivan, 'Do BITs Really Work: An Evaluation of Bilateral Investment Treaties and their Grand Bargain' (2005) 46 Harvard International Law Journal 67; for other authors who conclude that, although BITs increase FDI in general, States appearing before ICSID tribunals experience substantial losses in FDI see Todd Allee and Clint Peinhardt, 'Contingent Credibility: The

Therefore, it seems that these days there is a certain degree of 'backlash' against a liberal approach to foreign investment[33] and talk of a 'new protectionism' among politicians. In that context, the rise of SWFs possesses the potential to constitute the basis of a perfect storm; if States are unwilling to freely admit foreign investment by private investors and readily resort to protectionism, we can only imagine how they will respond to SWFs' investments. This is why it becomes extremely important to properly define the scope of application of these Treaties and examine to what extent foreign investment is protected by them.

### 4. The Protection of FDI and related Legal Concepts: Right of Admission and Right of Establishment

A major source of confusion about the extent of protection offered to foreign investment by these international instruments is that they use different terms to describe the same or similar factual situations.

International instruments, in order to deal with the freedom of investment, often revert to the concepts of freedom of establishment or freedom of movement of capital,[34] something that is often the source of great confusion. An investment, however, usually requires or, in any case, involves both the freedom of capital movement and the freedom of establishment. In that context, the meaning of the terms 'right of admission' and 'right of establishment' as well as their relationship has to be clarified.

First of all, when an investment is only short-term and does not require a significant commercial presence, a right of admission will suffice to allow the investor to conduct business.[35] A typical example would be portfolio investment in a local business.

Often, though, when a permanent business presence is necessary or preferred by the investor – since in many occasions it is economically more sensible – full establishment rights are necessary. The right of establishment has to be distinguished from a right of

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Impact of Investment Treaty Violations on Foreign Direct Investment' (2011) 65 International Organization 401.

33 See Michael Waibel and others (eds), *The Backlash against Investment Arbitration: Perceptions and Reality* (Kluwer Law International 2010).

34 Juillard (n 19) 329.

35 Ignacio Gomez-Palacio and Peter Muchlinski, 'Admission and Establishment' in Peter Muchlinski, Federico Ortino and Chistoph Schreuer (eds), *Oxford Handbook of International Investment Law* (Oxford University Press 2008) (n 35) 231; Rudolf Dolzer and Christoph H Schreuer, *Principles of International Investment Law* (OUP, New York 2008) 80.

admission,[36] and may be defined 'as the right for nationals of one country to set up a permanent presence within the territory of another country for the purpose of conducting economic activities other than activities of a salaried character'.[37] Certain investments, like the purchase or the acquisition of a domestic business necessarily requires the establishment of a permanent presence. In that sense, direct investment, in most cases, requires freedom of establishment; this, however, is not required for portfolio investment.[38]

Different economic operations with a cross-border element would require some of these freedoms to be in place, in order for the operator to be able to conduct business. Most of the time, however, where a long-term direct investment is necessary in order to conduct business − involving not only the transfer of capital but also the transfer of productive assets that remain under the control of the investor − then the rights of admission and rights of establishment need to be simultaneously present to ensure an effective investment.[39]

These rights are to a significant extent protected by a combination of Treaties. The fact, however, that different legal concepts are used to protect the bits and pieces of a usually unified economic operation, generates a lot of confusion. Therefore, it is important to explore the extent to which both the GATS and some of the BITs actually limit the discretion of the States to block SWF direct investment, by clarifying the extent of these rights under each agreement.

## C. The Pre-establishment Protection of SWFs' Investments under the GATS

The GATS constitutes the counterpart of the GATT dealing with the regulation of trade in services. Admittedly, the underlying economic rationale for the liberalisation of trade in goods is largely analogous to the liberalisation of trade in services.[40]

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36 See Ibrahim FI Shihata, 'Recent Trends Relating to Entry of Foreign Direct Investment' (1994) 9 ICSID Review 47.

37 Juillard (n 19) 323.

38 ibid 332.

39 Gomez-Palacio and Muchlinski (n 35) 232.

40 See Brian Hindley and Adasdair Smith, 'Comparative Advantage and Trade in Services' (1984) 7 The World Economy 369; see also Bernard Hoekman and Aaditya Mattoo, 'Services, Economic Development and the Next Round of Negotiations on Services' (2000) 12 Journal of International Development 283.

Nevertheless, a number of inherent differences between goods and services render the implementation of the rules much more complicated.[41]

Importantly, it will be submitted that some types of trade in services necessitate the liberalisation of FDI. In that context, the GATS contains rules that, to a significant extent, liberalise FDI and provide certain establishment rights to investors or – in this context – prospective traders in services. In fact, what will be submitted is that the GATS, in principle, provides potential investors with establishment rights. This is particularly relevant for SWFs since most of them have actually been investing in the field of services.

Consequently, the disciplines of the GATS with respect to the pre-establishment stage of investment in services will be analysed and, eventually, it will be submitted that foreign investment screening mechanisms could be *prima facie* found in violation of these disciplines.

### 1. Trade in Services and FDI in Theory

Trade in services is both conceptually and from an economic perspective quite different from trade in goods. Some services, similarly to goods, can be supplied without personal contact between the supplier and the consumer and thus, in that sense, are storable.[42] Other services, however, unlike goods, are for the most part intangible and cannot be shifted from place to place.[43] This non-transportability means that the provision of some services requires proximity of the provider of the service and the good or the person receiving it.[44] As a consequence, international transactions in services are much more likely to require some form of international factor movement than trade in

41 John H Jackson, 'Constructing a Constitution for Trade in Services' (1988) 11 The World Economy 187, 187.

42 GATS classifies these services under the term Mode 1 or Cross Border Trade in Services, which is defined as 'services supplied from the territory of one Member into the territory of any other Member'; see Article I.2(a) GATS.

43 See T Peter Hill, 'On Goods and Services' (1977) 23 Review of Income and Wealth 315.

44 Brian Hindley, 'Principles in Factor-related Trade in Services' in Patrick A Messerlin and Karl P Sauvant (eds), *The Uruguay Round: Services in the World Economy* (World Bank, Washington and United Nations Center on Transnational Transportation, New York 1990) 12, 12; this is the so called 'proximity burden' which places an additional cost burden on certain forms of services; on the 'proximity burden' see Elisabeth M Christen and Joseph F Francois, *Modes of Delivery in Services* (CEPR Discussion Paper 7912, Centre for Economic Policy Research, 2009)

goods.[45] In early theoretical works, the first category of services were coined 'non-factor services' whilst the latter 'factor-services'.[46]

Therefore, the epistemic community quite early on suggested that negotiating a comprehensive new agreement on trade in services[47] should also focus on factor movement, including the movement of capital – ie, FDI – and the (temporary) movement of service suppliers.[48] This was also implicitly acknowledged by UNCTAD – an organisation that was quite sceptical towards trade in services – which insisted that even if some services transactions could be viewed as trade, these were exceptions to the more typical phenomenon of services delivery *via* FDI, which was and should remain outside the jurisdiction of the then GATT.[49] Nevertheless, it should be noted that, in recent years, 'advances in information and communication technologies are increasingly permitting cross-border, "disembodied" trade in services'[50]—but the GATS largely reflects the perception of services at the time.

In that context, developing countries were hostile to this idea and unwilling to negotiate a global free investment regime, especially under the GATT.[51] Therefore, at these very early stages of research and informal discussion it was thought that a

45 Hindley (n 44) 12.

46 Bernard Hoekman, 'Introduction' in Bernard Hoekman (ed), *The WTO and Trade in Services*, vol I (Edward Elgar Publishing 2012) xvi.

47 It has to be noted, however, that a long time before this discussion begun, there was a first attempt to formulate principles concerning FDI as a part of the abortive Havana Charter, the charter of the defunct International Trade Organization. 54 countries signed the Charter on March 24, 1948 but it was never entered into force since the Congress of the United States rejected it. For a more detailed discussion on the Havana Charter see Andrew Paul Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer law international 2009) 19–20.

48 Brian Hindley, 'Service Sector Protection: Considerations for Developing Countries' (1988) 2 The World Bank Economic Review 205, Chapter I.5; See also Herbert G Grubel, 'All Traded Services are Embodied in Materials or People' (1987) 10 The World Economy 319 who first suggested that all trade was embodied either in goods or in factors (people, FDI).

49 See UNCTAD, *International Trade in Goods and Services: Protectionism and Structural Adjustment* (UNCTAD TD/B/1008, 1985).

50 See Joseph Francois and Bernard Hoekman, 'Services Rrade and Policy' (2010) Journal of Economic Literature 642, 642 *et seq* and accompanying citations, who explain that technological progress has to a significant extent reduced the proximity burden to a non-issue.

51 William J Drake and Kalypso Nicolaidis, 'Ideas, Interests, and Institutionalization: "Trade in Services" and the Uruguay Round' (1992) 46 International Organization 37, 62.

conceptual boundary that separates trade in services and FDI would have to be invented, if these concerns were to be appeased.[52]

### 2. The Negotiating History of the GATS and FDI

In order to understand why the GATS is relevant in a debate regarding the regulation of global FDI flows, it is worth examining the negotiating history of the agreement since it will assist in unlocking the true intentions of the drafters of the Treaty.[53] Examining the negotiating history of the GATS will not only provide us with an insight on the historical context of the agreement but will also shed light on the object of the Treaty—an exercise that might prove to be especially relevant in clarifying the obscure concepts that are involved in this debate.[54]

Initially, when the discussion on including services in the GATT was initiated, the United States suggested that only non-factor services should be included in order to avoid the contentious issue of FDI and rights of establishment. Soon, however, US service suppliers put pressure on the US government to include rights of establishment in the negotiations. Developing countries were very hostile to this idea at the early stages of the discussions even going as far as suggesting that the movement of factors of production across borders is at odds with the economic theory of free trade which presupposes immobility of these factors.[55] Soon, however, some realised – while still sceptical about FDI – that almost all of the services for which trade without establishment is possible are those in which developed countries at the time appeared to have a comparative advantage.[56] Therefore, gradually they started softening their position and, at least, considered the issue.[57] In the meantime, research in the area of

52 ibid 62; On that note, for a very influential article which attempted to delineate trade and investment see Gary P Sampson and Richard H Snape, 'Identifying the Issues in Trade in Services' (1985) 8 The World Economy 171, 171–182.

53 For an explanation on why, given the absence of a concrete economic theory explaining trade in services fully, the intention of the drafters of the GATS needs be seriously taken into account see Juan A Marchetti and Petros C Mavroidis, 'The Genesis of the GATS (General Agreement on Trade in Services)' (2011) 22 European Journal of International Law 689, 689–690.

54 See ibid 689–690.

55 See Brazilian Delegate, Definition of Trade in Services, GATT Doc MTN.GNS/3 [27]–[28].

56 Hindley, 'Principles in Factor-related Trade in Services' (n 44) 14.

57 This development, however, was somewhat unrelated to the aforementioned debate; rather, the catalyst was the formation of the 'Café au Lait' Group which comprised of both developed and developing countries—the first time these fault lines were disrupted. For more on this see Amrita Narlikar,

services was advancing and a major conceptual breakthrough came with a paper by Sampson and Snape in 1985 that, for the first, classified services in four different categories that correspond to today's four Modes of Trade in Services under the GATS.[58] Eventually, some developing States realised that the need of service suppliers to move capital across the border is symmetrical with the need of providers of labour-intensive services to locate unskilled and semiskilled labour in potential markets.[59] Thus, in 1987, Bhagwati − perhaps inspired by Sampson and Snape − suggested that a possible solution to all these problems is to introduce a right of establishment but to define in a way that includes a right to locate labour in a country temporarily for the purposes of supplying a service.[60]

These developments constitute the background against which the negotiations to conclude an international agreement on trade in services commenced. The Uruguay Round of Negotiations was initiated on 15 September 1986 and a separate Group of Negotiations in Services was set up as the forum to hold the negotiations. During these discussions there was already some consensus in academic and policy circles that there is no easy way to separate 'pure' trade in services and FDI and that the situation resembles a continuum with each at the respective end.[61] In between, though, they recognised the existence of a hybrid 'establishment trade' which would probably need to be included in the GATS while they summarily agreed that portfolio investment is not trade.[62] This hybrid trade included the various organisational mechanisms (such as joint ventures, licensing agreements, franchises, agencies, representative offices etc) through which a foreign market can be accessed.[63] Usually, however, foreign firms do not have exclusive

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*International Trade and Developing Countries: Bargaining Coalitions in the GATT & WTO*, vol 13 (Taylor & Francis 2003).

58 See Sampson and Snape (n 52).

59 Hindley, 'Principles in Factor-related Trade in Services' (n 44) 14.

60 See Jagdish N Bhagwati, 'Splintering and Disembodiment of Services and Developing Nations' (1984) 7 The World Economy 133.

61 Drake and Nicolaidis (n 51) 72.

62 ibid 72.

63 See V N Balasubramanyam, 'International Trade in Services: The Issue of Market Presence and Right of Establishment' in Peter Robinson, Karl P Sauvant and Vishwas P Govitrikar (eds), *Electronic Highways for World Trade: Issues in Telecommunications and Data Services* (Westview Press, Colorado 1989).

ownership over these arrangements, and, thus, including only them in the ambit of the GATS was a result considered unacceptable by the US and the EC.[64]

A transitional compromise was then found that specified that a foreign provider would be considered as a services 'trader', provided that he offers services in a sector that the country has opened up to competition and just for a limited amount of time.[65] This would mean that investment would have to be temporary only. Developing countries were still quite uncomfortable with this idea and to extract some extra concessions they brought up the issue of 'symmetry' between factors of production at the negotiating table.[66] India particularly was a main proponent of this idea. This is how Modes 3 and 4 of the GATS were born; a limited right of labour mobility (Mode 4) would have to accompany the limited liberalisation of FDI (Mode 3).

Later on during the negotiations, the exact details of that trade-off became clearer. Developing countries were demanding rights of access not only for skilled (executive, managers, specialists etc) but also unskilled labour.[67] At the same time, developed countries realised that the criteria that they had come up with in order to distinguish between FDI (which would entail a permanent presence and establishment rights) and the nebulous 'time-limited presence for a specific purpose' were as restrictive as the alternatives initially considered (joint ventures, franchise etc);[68] indeed, empirical data indicated that these arrangements only represent a small percentage of the overall trade in services and that the majority of it does in fact involve pure FDI and permanent establishment.[69] This position became untenable and developed countries held on to their views on this point.

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64 Drake and Nicolaidis (n 51) 72.

65 ibid 72; see also Group of Negiotations on Services, Elements for a Draft Which Could Permit Negotiations to Take Place for the Completion of All Parts of the Multilateral Framework, MTN.GNS/28 (18 December 1989), a document circulated by the GATT Secretariat after the Montreal and before the Brussels Ministerial Conference which indicates the several alternative versions that could form the basis of a compromise between developed and developing countries on the issue of 'commercial presence'.

66 Arguably, some developing countries were probably influenced by the aforementioned paper by Bhagwati and realised that the epistemic community concept of 'preferred modes of delivery' includes labour factors as well and can be used to their advantage.

67 Drake and Nicolaidis (n 51) 94.

68 ibid 94.

69 For this view see Bhagwati (n 60); see also Bernard Hoekman, 'Assessing the General Agreement on Trade in Services' in Bernard Hoekman (ed), *The WTO and Trade in Services*, vol 2 (Edward Elgar Publishing 1996) 68 who also recognises the need to establish a long-term physical presence through FDI

Soon developing countries realised that this battle could not be won and appeared to be ready to allow permanent establishment of foreign suppliers in exchange for more concessions on labour mobility.[70] Conceptually, this was a breakthrough since it shattered the axiom that the trade/investment distinction that can be found in goods should be applied to trade in services and replaced with what came to be known as the 'four modes of supply'. FDI would, thus, come under the scope of application of the GATS. Accordingly, Mode 3 Trade in Services covers foreign suppliers who establish and control an affiliate, subsidiary or representative office within the territory of the importing Member.

### 3. 'Commercial Presence' under the GATS and FDI

The vehicle used to facilitate the inclusion of FDI within the scope of the GATS is the concept of 'commercial presence'. The aforementioned debate is rather informative on the exact meaning of the term 'commercial presence' and the context of the agreement will further elucidate our interpretation later on.

The text of Article XXVIII(d), which gives the definition of commercial presence reads as follows:

> [C]ommercial presence' means any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service.[71]

First of all, it needs to be noted that according to the wording of the provision, the relevant juridical person need not be a *new* juridical person,[72] but may also be created

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and underscores the fact that investment in services accounts for a large part of inward FDI in most host countries; see also UNCTAD, *World Investment Report* (United Nations, Geneva, 2007) which observes that 'as for the empirical data, it is characteristic of the major importance of FDI in services trade that at the early 1990s some 50% of the global stock of FDI involved services activities while, as of 2005, this figure rose to 60%, with the global stock of FDI exceeding US$10 trillion'.

70 Drake and Nicolaidis (n 51) 94.

71 Article XXVIII(d), GATS (emphasis added).

72 Notably Article XXVIII(l) GATS defines 'juridical person' as:

> [A]ny legal entity duly constituted or otherwise organized under applicable law, whether for profit or otherwise, and whether privately-owned or governmentally-owned, including any corporation, trust, partnership, joint venture, sole proprietorship or association.

through the acquisition of an *existing* entity in the host Member. It is important, however, to clarify the meaning of the term 'acquisition' in order to properly construct the outer limits of the scope of Mode 3.

It has to be admitted that the term acquisition implies a degree of control over the domestic juridical person. This view seems to be supported implicitly by Article XXVIII(n) of the GATS which defines a juridical person as:

> (i) 'owned' by persons of a Member *if more than 50 per cent* of the equity interest in it is beneficially owned by persons of that Member; (ii) 'controlled' by persons of a Member if such persons have *the power to name a majority of its directors or otherwise to legally direct its actions*.[73]

This definition, however, operates in a different context entirely. In fact, it clarifies the meaning of the term 'juridical person of another Member'[74] and, thus, does not refer directly to the term 'acquisition'. This indicates that this interpretation, which seems to be the norm in the literature, should be treated with scepticism. The fact that commercial presence requires this level of control does not mean that the GATS does not come into play at all until after a foreign service supplier has acquired a domestic juridical person as has been argued by several scholars.[75] Rather, it is submitted, that any measure that can potentially inhibit the acquisition of a juridical person by a foreign service-supplier with the purpose of supplying a service is in principle covered by the scope of application of the GATS and, depending on the specific commitments made by that Member, could be a violation of the GATS. As the Panel in *China – Publications and Audiovisual Products* has recently confirmed:

> [F]or the purpose of Article XVII [...] the term 'service suppliers of another Member' supplying a service through

This provision expressly states that the public or private nature of a juridical person is simply irrelevant for the purposes of the GATS and, thus, any argument that would exclude SWFs on that basis would be unsubstantiated; for more on the ownership-neutrality rules of the WTO see Julia Ya Qin, 'WTO Regulation of Subsidies to State-owned Enterprises (SOEs) – A Critical Appraisal of the China Accession Protocol' (2004) 7 Journal of International Economic Law 863.

73 Article XXVIII(n) GATS (emphasis added).

74 See Article XXVIII(n) which seems to be directly referring to Article XVIII(m) GATS.

75 See, eg, Aaditya Mattoo and Arvind Subramanian, 'Currency Undervaluation and Sovereign Wealth Funds: A New Role for the World Trade Organization' (2009) 32 The World Economy 1135, 1149.

> commercial presence includes entities that [...] *seek* to establish in the host Member.[76]

Therefore, it is true that the GATS would not cover measures that concern portfolio investment or non-controlling stakes in domestic service suppliers *per se*. If, however, these measures also indirectly inhibit a foreign service-supplier from establishing commercial presence, then they would indeed be captured. It is, thus, submitted that the intentions of the foreign service-supplier are irrelevant; it does not matter if a specific foreign service-supplier is, in fact, attempting to acquire a domestic juridical person. If the measure in question has the potential *to affect* the establishment of commercial presence it falls under the scope of application of the GATS. Therefore, it could be suggested that, *prima facie*, Mode 3 also covers the 'pre-establishment' phase of an investment in services: measures that restrict the possibility to set up a commercial presence (and, thus, to invest) are within the scope of the GATS.[77]

In fact, the historical context in which the term was adopted confirms such an interpretation. Admittedly, the term emerged during the 1980s, when the debate on trade in services first begun to take shape. The notion initially was a limited form of full establishment rights and referred 'to the activities of representative offices, but not to agencies, branches or subsidiaries of commercial banks'[78] and it first appeared as a footnote to the Declaration on Trade in Services of the US−Israel FTA indicated.[79] During the discussions of the Uruguay round it was still envisaged as an intermediate position or as a compromise between full establishment rights for foreign market suppliers and some other form of 'limited presence'. Indeed, even up until quite late during the negotiations, it was assumed that the term would mean 'something less' than full establishment rights. A good example is the European Community's proposal that attempted to draw a distinction between short-term and long-term commercial presence,

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76 *China – Publications and Audiovisual Products* Appellate Body Report, WT/DS363/AB/R, adopted 19 January 2010, DSR 2010:I, 3 [7.974] (emphasis added).

77 Bart De Meester and Dominic Coppens, 'Mode 3 of the GATS: A Model for Disciplining Measures Affecting Investment Flows?' in Zdenec Drabek and Petros C Mavroidis (eds), *Regulations of Foreign Investment: Challenges to International Harmonization* (World Scientific Publishing Company Incorporated 2013) 108; see also Background Note by the Secretariat, Mode 3 – Commercial Presence, S/C/W/314 (7 April 2010) [9].

78 Hindley, 'Principles in Factor-related Trade in Services' (n 44) 16.

79 Footnote to the Declaration on Trade in Services annexed to the Agreement on the Establishment of a Free Trade Area between the United States and Israel *cited in* ibid 15–16.

the latter being only another name for full establishment rights.[80] As was explained earlier, however, developed countries soon realised that anything short of full establishment rights would not make sense and stood their ground while developing countries eventually gave in after extracting some concessions. The term 'commercial presence' was nevertheless kept but would now cover all types of FDI in services (provided of course they were positively listed by the relevant States). Therefore, 'commercial' presence is not to be temporary or limited in any other way and, thus, – at least in principle[81] – FDI in the field of services, a mode of delivery through which almost 60% of trade in services occurs,[82] falls within the scope of application of the GATS. Indeed, from that perspective, Mode 3 in services trade amounts to an international agreement to liberalise FDI.[83]

For all these reasons, it is safe to assume that the proper meaning of the term 'commercial presence' under the GATS covers the pre-establishment stage of FDI and any measure that could potentially inhibit the establishment of foreign service-suppliers is subject to any commitments that a Member State has undertaken. Arguably, any contrary interpretation would render commitments on Mode 3 utterly meaningless—an unwanted outcome for all Members involved.

### 4. Market Access under the GATS and Establishment Rights

#### *(i) Market Access within the Architecture of the GATS*

The most pertinent question related to this thesis, however, is whether the GATS provides SWFs with a right to invest in the field of services. In other words, it is important to ascertain whether entities, such as SWFs, are protected under the substantive provisions of the agreement not only after they have established a presence in the foreign market, but also when they are attempting to do so.

Despite the fact that, as explained earlier, the scope of Mode 3 covers FDI in the field of services both at the post- and the pre-establishment level, the architecture of the

80 European Communities, Definition of Trade in Services GATT Doc MTN.GNS/3.

81 For instance, Aviation Services have been kept out of the GATS; see GATS Annex on Air Transport Services (1994).

82 Guy Karsenty, Trends in Services Trade under GATS (Presentation at the WTO Symposium on Assessment of Trade in Services, 2002).

83 Mitsuo Matsushita, Thomas J Schoenbaum and Petros C Mavroidis (eds), *The World Trade Organization: Law, Practice and Policy*, vol 127 (2nd edn, Oxford University Press 2006) 617.

GATS complicates things to some extent. Unlike the GATT, not all substantive provisions of the GATS are of general application and offered *ab initio* by all Contracting States. The Most-Favoured Nation and Transparency obligations apply across the board from the moment of the accession to the GATS; on the contrary, some of them (namely National Treatment and Market Access) are specific commitments and States can inscribe limitations on or even opt-out of altogether. Notably though, any decision about the level of access the State wishes to commit to needs to respect the general obligations of the GATS. Therefore, the State can choose to keep its market completely inaccessible to foreign market suppliers, provided it does on an MFN basis[84] and while respecting the transparency requirements.[85] Therefore – unless the Member State has undertaken certain Market Access or National Treatment commitments towards its trading partners – the fact that the scope of application of GATS Mode 3 in principle extends to the pre-establishment stage of an investment would not in itself mean that foreign investors immediately enjoy full pre-establishment rights. The exact nature of specific commitments needs to be examined in order to reveal the nature and extent of these rights.

Admittedly, if a commitment to offer National Treatment to foreign market suppliers has been made, this would, in fact, translate to National Treatment at the pre-establishment stage of FDI. This would be tantamount to full establishment rights for foreign direct investors. Nonetheless, exactly because of the very intrusive character of such a commitment and the relatively slow pace of liberalisation in services, such commitments are not that common. On the other hand, Market Access commitments are more common but their exact nature and implications are not always very clear due to complex drafting.

In this thesis, it will be submitted that a commitment by a State to offer Market Access to foreign market suppliers could have significant implications for the pre-

[84] Note however that Market Access has to be extended to all foreign service suppliers on a non-discriminatory basis even when the respective State has listed an MFN exemption; thus, an MFN exemption can only provide legal cover for better treatment of *some* trading partners only when the other Members receive *at least* the minimum standard of Market Access and National Treatment appearing in a Member State's Schedule. Also, temporal limitations on MFN apply and − in principle − it was envisaged that they would expire after 10 years; see *US – Gambling (Panel)* (n 11) [6.265] and fn 821; for more on this view see also Panagiotis Delimatsis, *International Trade in Services and Domestic Regulations: Necessity, Transparency, and Regulatory Diversity* (Oxford University Press, 2008 2007) 131; Rudolf Adlung and Antonia Carzaniga, 'MFN Exemptions Under the General Agreement on Trade in Services: Grandfathers Striving for Immortality?' (2009) 12 Journal of International Economic Law 357.

[85] Delimatsis (n 84) 130.

establishment rights of potential markets suppliers, ie, the investors. Therefore, if SWFs can in principle be services suppliers then they would be covered by the Market Access obligations of the GATS—irrespectively of the fact that Mode 3 does not cover portfolio investment *per se*.

*(ii) Market Access as an Obligation to Offer Pre-establishment National Treatment to FDI*

The Market Access obligation is to be found in Article XVI GATS, and reads as follows:

> 1. With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule.
>
> 2. In sectors where market-access commitments are undertaken, the measures which a Member shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in its Schedule, are defined as:
>
> (a) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;
>
> (b) limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test;
>
> (c) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test;
>
> (d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test;
>
> (e) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and

> (f) *limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign* investment.[86]

Article XVI:2(f) is important for the purposes of this thesis since it prohibits quantitative limitations on foreign investment. Nevertheless, this does not necessarily mean that any restrictions on inwards capital movements are outlawed. Arguably, the opening up of Mode 3 services trade does not necessarily entail the liberalisation of international investment since a State could allow Mode 3 services trade and at the same time require the prospective market suppliers to raise the capital needed locally.

That is not, however, the end of the matter since perhaps the most important provision of this Article is found in its fine print. The infamous footnote number 8 to Article XVI:1 provides that:

> If a Member undertakes a market-access commitment in relation to the supply of a service through the mode of supply referred to in subparagraph 2(a) of Article I and if the cross-border movement of capital is an essential part of the service itself, that Member is thereby committed to allow such movement of capital. *If a Member undertakes a market-access commitment in relation to the supply of a service through the mode of supply referred to in subparagraph 2(c) of Article I, it is thereby committed to allow related transfers of capital into its territory*.[87]

This footnote indicates the intention of the drafters of the GATS to limit the autonomy of the Members in relation to the regulation of inwards financial flows. The reason was that, as we explained earlier, there is partial overlap between capital movements and trade in services. The overlap is limited and can only surface on two occasions: 1) in the context of international financial services which always entail the cross-border movement of capital; and 2) in the context of the establishment of a commercial presence by a foreign service supplier. Evidently, international investment is by definition a capital movement and any limitations imposed on capital movements by the recipient State could jeopardise one of the three modes through which trade in services is conducted – especially Mode 3 – a situation the drafters of the GATS decided

[86] Article XVI GATS (emphasis added).

[87] Footnote 8, Article XVI:1 GATS (emphasis added).

in principle to prohibit to the extent necessary to serve performance of commitments.[88] This would be exactly why Footnote 8 requires States to allow transfers of capital 'in relation' to the supply of a service instead of 'necessary' into its territory.[89]

In that context, it could be suggested that Article XVI:2(f) GATS is to be read in conjunction with footnote 8 resulting in the prohibition of measures that place limitations on the participation of *foreign* capital. As a consequence, any measure that places any quantitative limitations which discriminate between flows of capital on the basis of their origin would violate Article XVI:2(f). Nonetheless, such an interpretation is far from being uncontroversial.

A contrary proposition, suggests that Article XVI:1 ought to also be read in conjunction with XVI:2(f). Such a reading indicates that measures covered by paragraph 2 are those with regard to the treatment of '*service suppliers* of any other Member'.[90] This means that in the case of a service supplied through Mode 3, a commercial presence needs to have already been established. According to Article XXVIII, though, a commercial presence exists if a juridical person is 'owned or controlled' by persons of another WTO Member. In the terms of Article XXVIII lit n,[91] a juridical person is 'owned' by persons of another Member if more than 50 per cent of the equity interest is owned by persons of that Member and is 'controlled' by persons of a Member if such persons have the necessary voting power to name the majority of directors or otherwise control the company. Under this interpretation, the prohibition of Article XVI:2(f) only applies when foreign participation has already exceeded the aforementioned threshold and, thus, any limitation on foreign capital ownership *below* the threshold of ownership or control does not fall under the scope of application of Article XVI GATS.[92]

88 Note however that this limitation is very specific and should not be understood as a provision that generally promotes the liberalisation of the capital account; for an example of that see OECD Code of Liberalization of Capital Movements.

89 Pasini (n 10) 600. On a related issue, it is disputed whether Footnote 8 also covers the outflow of capital necessary for the provision of a Mode 3 service. The ordinary meaning of the phrase '[...] allow related transfers of capital *into* its territory' suggests that repatriation of capital does not come within the purview of footnote 8; for authors in favour of this view see Panagiotis Delimatsis and Martín Molinuevo, 'Commentary to Article XVI GATS (market access)' in Rüdiger Wolfrum, Peter-Tobias Stoll and Clemens Feinäugle (eds), *WTO – Trade in Services*, vol 6 (Martinus Nijhoff, Leiden and Boston 2008) 373.

90 Delimatsis and Molinuevo (n 89) 389.

91 Article XXVIII lit (n) GATS.

92 Delimatsis and Molinuevo (n 89) 389.

Otherwise, the argument goes, measures that limit foreign investments that do not amount to 'control' or ownership of a service provider would be covered by the GATS— an 'odd' outcome since the GATS applies to 'measures affecting trade in services' and if no ownership or control is acquired through the investment, then no 'trade in services' is at stake.[93] Member States under this scenario may well legislate and implement measures that restrict foreign participation to less than 50 per cent, irrespective of their Article XVI GATS commitments. Unfortunately, the Appellate Body decision in *US – Gambling* does not offer us any guidance on the relationship between Articles XVI:1 and XVI:2 and has decided to leave the issue 'to another day'.[94]

The aforementioned view, however, should be treated with significant scepticism if not hostility. Article XVI:1 does indeed refer to 'market suppliers of any other Member'. This provision though probably echoes Article XXVIII(m) of the GATS, which requires the juridical person that owns or controls the commercial presence to be engaged in substantive business operations in the territory of the Member where it is constituted or organised *or in any other Member*. The purpose of these provisions was to prevent a 'shell company' from being set up in a WTO Member while the substantive business operations take place in a country that is not a WTO Member.[95] Therefore, Article XVI in reality refers to juridical persons that supply a service in a WTO Member and seek to establish commercial presence in another and not to already 'domesticated' market suppliers that are controlled by a foreign juridical person.[96]

Furthermore, the argument that no 'trade in services' is affected is equally problematic. FDI in the field of services does not follow the traditional investment/trade distinction, which is encountered in the field of goods. A limitation on foreign investment will indeed adversely affect trade in services *per se* since some types of trade

93 De Meester and Coppens (n 77) 104.

94 *US – Measures Affecting the Cross-Border Supply of Gambling and Betting Services* WTO Appellate Body, WT/DS285/AB/R, adopted 20 April 2005, DSR 2005:XII, 5663 (Corr1, DSR 2006:XII, 5475) [256].

95 De Meester and Coppens (n 77) 105; For instance, it is no coincidence that no such similar requirement exists for natural persons, see Article XXVIII(m)(ii)(1) GATS.

96 See also Petros C Mavroidis, 'Highway XVI Re-visited: The Road from Non-discrimination to Market Access in GATS' (2007) 6 World Trade Review 1, *esp* 10 *et seq*. who submits a series of additional arguments supporting the thesis that Article XVI in general does not apply to domestic market suppliers. See also *infra* fns 124,125 and accompanying text.

in services *necessarily* involve international investment, which requires the movement of capital across borders.

Moreover, a closer look at Article XVI:2(f) indeed suggests that no limitations on '[...] foreign investment' are envisaged and no reference to commercial presence is made. The reference to 'foreign investment' cannot simply be a coincidence or poor drafting since the term is not used anywhere else in the Treaty[97] but must have been intended to refer to cases where foreign participation does not suffice to establish commercial presence and, as a consequence, we can assume that these are covered by Article XVI:2(f). Indeed, one could question what would be the purpose of a measure that limits foreign participation *after* a foreign person has already acquired the control of a domestic company.

This interpretation seems to be supported to some extent by the ruling of the Appellate Body in *China – Publications and Audiovisual Products* where it was decided that a Chinese regulation limiting foreign equity participation − by providing that the Chinese co-operator shall hold no less than 51% equity in a contractual joint venture − was in violation of Article XVI:2(f) since China had not scheduled this limitation.[98] By implication, this means that foreigners with a 49% of equity and thus not necessarily having commercial presence have to be granted market access by China.

Furthermore, the Panel, when interpreting the term 'market suppliers' under Article XVII, made a very important note that by implication verifies the aforementioned interpretation. The panel stated that:

> [F]or the purpose of Article XVII [...] the term 'service suppliers of another Member' supplying a service through commercial presence includes entities that [...] *seek to establish* in the host Member.[99]

This indicates that the scope of application of the GATS when referring to market suppliers extends not only to the suppliers already offering services in the relevant market but also to *potential* market suppliers that seek to supply services through 'the constitution, acquisition or maintenance of a juridical person'.[100] If the scope of

97 Delimatsis and Molinuevo (n 89) 389.

98 *China – Publications and Audiovisual Products (AB)* (n 76) [7.1367].

99 ibid [7.974] (emphasis added).

100 Article XXVIII (d) (i) GATS.

application extends to potential market suppliers then the reference to foreign investment is not that unusual. Indeed, it becomes clear that any measure that can potentially affect commercial presence, including at pre-establishment and post-establishment phase of an investment, falls under the general purview of the GATS.[101]

This would amount to a commitment to offer foreign investors in the services sector pre-establishment access to a domestic market,[102] a very far-reaching commitment that is often disregarded. More specifically, if a State has undertaken a market access commitment under Mode 3, this means that it has assumed the obligation to permit foreign service-suppliers to acquire equities in a domestic services company or to even establish a new company.[103] In that sense, foreign investment in services remains able to enter the host country's market at the desired level of participation and involvement with domestic service suppliers.[104] If a Member State wants to maintain restrictions on the participation of foreign capital, it needs to schedule these restrictions.[105]

However, the fact that the scope of application of Article XVI, and specifically XVI:2(f), extends to the pre-establishment stage of foreign investment does not mean that a full Market Access commitment offers foreign investors complete unimpeded access to a foreign market. Rather, it prohibits specific types of discriminatory treatment at the pre-establishment stage of an investment.[106] Indeed, even though Article XVI GATS in principle outlaws an exhaustive list of quantitative measures that can be both discriminatory and non-discriminatory,[107] it is submitted that subparagraph (f)

101 Martín Molinuevo, *Protecting Investment in Services* (Kluwers Law International, The Netherlands 2012) 80.

102 UNCTAD, *International Investment Agreements in Services* (UNCTAD Series on International Investment Policies for Development, 2005) 32.

103 Pasini (n 10) 598; Andrew T Guzman and Alan O Sykes, *Research Handbook in International Economic Law* (Edward Elgar Publishing 2007) 256.

104 Molinuevo (n 101) 84.

105 See Nellie Munin, *Legal guide to GATS*, vol 31 (Kluwer Law International 2010).

106 Molinuevo (n 101) 84; Delimatsis and Molinuevo (n 88) [22] who also note that the concept of 'market access' under Article XVI is misleading since it does not reflect the ordinary meaning of the words 'market' or 'access'.

107 An important aspect of Article XVI GATS is that it covers both discriminatory and origin-neutral quantitative limitations and, in that sense, its scope of application is wider than that of Article XI GATT. Indeed, Article XVII:1 explicitly states that it applies to all measures *affecting* the supply of services. Thus, there is a partial overlap between the scope of application of Articles XVI and XVII when it comes to quantitative restrictions of a discriminatory nature. This is not necessarily problematic since the Members have laid down a scheduling convention according to which:

specifically addresses limitations on *foreign* equity participation and, thus, concerns measures that are inherently discriminatory.[108] Therefore, this provision normatively overlaps with the national treatment requirement of Article XVII.[109]

This understanding helps us conceptualise the proper meaning of this provision irrespective of the possible combinations and/or conflicts that could arise because of differences in scheduling of these measures. In a nutshell, Article XVI:2(f) can be described as a limited extension of the National Treatment obligation[110] at the pre-establishment stage of an investment at least to the extent that it concerns limitations on the inward movement of investment. This does not mean that anything is added to the National Treatment obligations of Article XVII. Arguably, if a Member State has decided to accord full National Treatment to foreign service-suppliers, this would imply that such treatment is to be extended to the pre-establishment stage of an investment too.[111] Rather, if a member State has an 'unbound'[112] commitment on National

> Measures inconsistent with both Article XVI and XVII shall be inscribed in the column relating to Article XVI. In this case the inscription will be considered to provide a condition or qualification to Article XVII as well.

108 Erich Vranes, 'The WTO and Regulatory Freedom: WTO Disciplines on Market Access, Non-Discrimination and Domestic Regulation Relating to Trade in Goods and Services' (2009) 12 Journal of International Economic Law 953, 970.

109 This interpretation is supported by the lack of any clause like the Note Ad Article III of that GATT, by the Scheduling Guidelines, the work of the Committee on Specific Commitments and the literature. See respectively Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services MTN.GNS/W/164 (3 September 1993) [4]: 'The list [in Article XVI:2] is exhaustive and includes measures which may also be discriminatory according to the national treatment standard'; Committee on Specific Commitments WTO Doc JOB(03)/213 (20 November 2003), attached as Annex I to Council for Trade in Services, Consideration of Issues Relating to Article XX:2 of the GATS, WTO Doc S/C/W/237 (24 March 2004) [3]; see also Joost Pauwelyn, 'Rien ne Va Plus? Distinguishing Domestic Regulation from Market Access under GATT and GATS' (2005) 4 World Trade Review 131, 148 *et seq*.

110 See also Mavroidis (n 96) 9 who suggests that Article XVI in its entirety should only apply to foreign market suppliers and, as such, it is only a list of the most frequent violations of National Treatment that the negotiators wanted to abolish.

111 ibid 21.

112 See 'Guide to Reading the GATS Schedules of Specific Commitments and the List of Article II (MFN) Exemptions' (*World Trade Organization*) accessed 12 November 2015:

> Where there are no limitations on market access or national treatment in a given sector and mode of supply, the entry reads NONE. This means that the country is BOUND by this commitment of no limitation […]. All commitments in a schedule are bound unless otherwise specified. In such a case, where a Member wishes to remain free in a given sector and mode of supply to introduce or maintain measures inconsistent with market access or national treatment, the Member has entered in the appropriate space the

Treatment, it would still need to specifically schedule any measure that falls under the scope of Article XVI if it has committed to provide Market Access.

Therefore, the overall conclusion we can draw from this analysis is that a Market Access commitment – and even more so a National Treatment commitment – actually constraints the Member States' competence to restrict inwards investment in the field of services unless these restrictions are of a non-discriminatory nature. In that context, what will be examined in the next section is whether foreign investment screening mechanisms could in principle violate these obligations—assuming commitments have been made.

## 5. Foreign Investment Screening Mechanisms and their Lawfulness under the GATS

Foreign investment screening mechanisms, as was analysed earlier, typically involve authorisation requirements and procedures to assess whether foreign investments could proceed on the basis of 'public interest', 'national security', or 'financial stability' considerations. It is indeed true that these mechanisms do not explicitly limit the participation of foreign equity – although they do possess the discretion both to limit and block a transfer of capital related to the 'acquisition of an enterprise' – and the GATS does not contain any express provisions dealing directly with them.[113]

It has, thus, been suggested that Article XVI GATS does not *per se* outlaw these mechanisms or any other pre-establishment authorisation schemes or shareholding limitations since they are not expressed in the form of quantitative limitations.[114] This raises the issue of whether Article XVI GATS covers also measures which *de facto* amount to any of the limitations described in Article XVI:2.

The WTO Panels and the AB have provided us with some limited guidance on the proper construction of Article XVI GATS on this point. The Panel in *US – Gambling* found that a prohibition to provide online gambling services violated Article XVI:2 (a) and (c) of the GATS since they constituted 'numerical quotas' amounting to zero[115]. The

term UNBOUND. It means that the country has stated that it does not take any commitment for this specific matter.

113 See Guzman and Sykes (n 103).

114 Molinuevo (n 101) 84.

115 *US – Gambling (Panel)* (n 11) [6.330].

Appellate Body agreed with this reasoning but noted that 'the words "in the form of" should not be ignored or replaced by the words "having the effect of", highlighting the fact that what is important for the purposes of Article XVI:2 (a) and (c) is not 'the form of limitations' but their *'numerical, or quantitative, nature'*.[116]

This interpretation indicates that measures which *de facto* limit the potential number of market suppliers and are not of a quantitative nature would probably not be captured by the prohibitions of Article XVI:2. Thus, measures of a *qualitative nature*, – ie, measures that regulate how a service must be supplied – would not be prohibited even if, as a consequence of that, less foreign market suppliers access the market (eg, because of additional costs or simply because they do not meet the requirements).[117] In the same vein, the Panel in *China – Publications and Audiovisual Products*, in attempt to uphold this distinction, found that a measure which provides that a Chinese joint venture partner should hold no less than 51% of any equity or the investment constitutes a Market Access limitation of Article XVI:2(f)[118] but noted that the phrase 'holding a dominant position' does 'not necessarily imply 'holding a majority of shares' in an entity'.[119] This would indicate that the Panel is holding on to the view that a measure needs to be in some sort of quantitative form in order to be regarded as a violation of Article XVI. At the very least though, it has to be admitted that when a measure renders a market completely inaccessible through a mode of supply for which a commitment has been made, this constitutes a violation of Article XVI.

*Prima facie*, it could be argued that foreign investment screening mechanisms have the potential of imposing restrictions of a quantitative nature that can render a market inaccessible for a specific market supplier. One might argue, however, that these committees would usually only prevent the possibility of acquiring an existing service supplier but would not impose any restrictions on Greenfield Investment.[120] This would

116 *US – Gambling (AB)* (n 94) [232] (emphasis added).

117 *US – Gambling (Panel)* (n 11) [6.304]; Pauwelyn (n 109) 164–166. This distinction, however, does not apply to measures that concern terms, conditions or procedures for authorisation of the establishment and expansion of a commercial presence in the case of financial services and they should not be considered as a restriction of market access; see Section B.6, *Understanding on Commitments in Financial Services*.

118 *China – Publications and Audiovisual Products (AB)* (n 76) [7.1376], [7.1388].

119 ibid [7.1376], [7.1388].

120 Greenfield Investment is defined as 'the creation of a subsidiary from scratch by one of more non-resident investors', see IMF Committee on Balance of Payments Statistics and OECD Workshop on International

indicate that they do not render a market completely inaccessible, but only restrict a certain means through which a service can be supplied within a certain Mode. A similar argument was made by the United States in the *US – Gambling* case, albeit rejected by the Panel:

> Accordingly, where a full market access commitment has been made for mode 1 [cross-border supply], a prohibition on one, several or all means of delivery included in this mode 1 would be a limitation on market access for the mode [under Article XVI]... If a Member desires to exclude market access with respect to the supply of a service through one, several or all means of delivery included in mode 1, it should do so explicitly in its schedule.

This outcome has been heavily criticised by Pauwelyn who argues that under such an interpretation 'any domestic service regulation would become a Market Access restriction simply because it implies "a prohibition on one, several or all means of delivery" of a committed mode of trade in services, irrespective of whether the regulation falls under one of the six definitions of Article XVI'.[121] It does indeed appear that the Panel and the Appellate Body should probably have been more careful when drawing the lines between quantitative and qualitative measures.

It is submitted, however, that the crucial difference between these two situations is that, in the case of a 'qualitative' measure, the foreign market supplier can theoretically conform to it and access the market while in the case of a 'zero-quota', no matter what he does, the market will remain inaccessible to him.

A first way of examining whether foreign investment screening mechanisms actually constitute 'quantitative' or qualitative' measures would be to consider the criteria on the basis of which the decision to allow the inflow of these investments is made.[122] As analysed previously, their decisions are based on 'strategic', 'market efficiency', 'financial stability' or even 'national security' considerations and, usually, do not set any conditions under which the acquisition of a domestic supplier could proceed. Even when they do possess such competence, they enjoy unfettered discretion in setting any conditions whilst the investor is never made aware of them in advance.

Investments Statistics – Direct Investment Technical Expert Group (DITEG), *Mergers and Acquisitions (M&As), Greenfield Investments and Extension of Capacity* (2004) 2.

121 Pauwelyn (n 109) 163.

122 De Meester and Coppens (n 77) 112.

Furthermore, these mechanisms possess the competence to block all FDI in a certain sector of the economy, something that would definitely constitute a quantitative limitation. Therefore, their decisions could hardly be described as qualitative. Arguably, it would be more accurate to admit that their decisions have the potential to restrict Market Access and, as a matter of fact, they often do. Consequently, these mechanisms – as they stand – are in violation of Article XVI GATS and must be scheduled as Market Access limitations.

A different conceptualisation of this issue could perceive any individual decisions to block specific investments by these screening committees as measures amounting to a zero-quota for this specific market supplier. Under this interpretation, it would be even easier to perceive these mechanisms as being in violation Article XVI GATS. An argument against such a proposition is that the GATS safeguards the competitive opportunities of foreign market suppliers as a whole and, thus, individual decisions to block FDI should be tolerated as long as they do not become endemic. Conceptually, however, it would be very difficult to draw such a line. The GATS, unlike the GATT, extends its scope of application not only to services but also to service suppliers. Therefore, every single service supplier is an indirect beneficiary of the treatment that has been promised to the rest of the WTO Members. One might also wonder what the answer to this question should be if the service supplier denied access to the domestic market is the only supplier of that WTO Member State.[123]

Perhaps more importantly, Mavroidis has made a very strong case that Article XVI GATS covers only foreign suppliers and, thus, it is nothing more than a list of the most frequent violations of national treatment.[124] Under such an interpretation, the negotiators in reality wanted 'to signal their desire to, in principle, abolish [these measures]'.[125] Therefore, for a domestic regulation to be in violation of Article XVI GATS, it would also have to be by definition *discriminatory*. Indeed, this approach seems to be the most plausible. Under this interpretation, foreign investment screening mechanisms appear highly questionable since they concern exclusively foreign investors (and, thus, potential market suppliers) and, as a consequence, are inherently discriminatory.

123 ibid 112.

124 See Mavroidis (n 96).

125 ibid 9.

In any case, it is submitted that every individual decision to block a specific investment amounts to a quantitative limitation on the percentage of capital a foreign market supplier can acquire. Indeed, it is an inherently discriminatory zero-quota and should, as a result, be prohibited under Article XVI of the GATS. Even when there are additional criteria which are of a qualitative nature, to the extent to which they contain any of the limitations specified in Article XVI (which they do since, as argued, blocking an investment would amount to a zero quota) they would have a quantitative effect and, as consequence, need to be scheduled as Market Access limitations as indicated by Guidelines for the Scheduling of Specific Commitments.[126]

For all these reasons, the provisional conclusion is that Article XVI of the GATS prohibits any discriminatory treatment of foreign markets suppliers that is expressed in a quantitative form. Furthermore, this treatment extends to the pre-establishment stage of an investment since the GATS covers any measure that could affect potential market suppliers (and thus investors). In that context, it is submitted that the decisions of foreign investment screening mechanisms to block SWFs' FDI constitute violations of Article XVI:2(f) since they amount to a discriminatory zero-quota on a means of delivery of a Mode 3 service. Consequently, and unless they are scheduled, they have to be considered unlawful.[127]

An important caveat has to be made though. The impact of the GATS is mitigated to some extent since several Members have chosen not to include certain sectors of their economy in their schedules of specific commitments.[128] Furthermore, some States have listed certain restrictions on Market Access and National Treatment with respect to commercial presence. Last but not least, some States – including the USA – have listed certain restrictions on government-owned foreign suppliers, which would apply in the case of SWF investments.[129]

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126 Guidelines for the Scheduling of Specific Commitments Under the General Agreement on Trade in Services (GATS), S/L/92 (28 March 2001) [10].

127 Gomez-Palacio and Muchlinski (n 35) 196.

128 Eg, only 16 of 122 GATS signatories have listed higher education; 23 hospital services; 29 wholesale and retail trade. See also Joel P Trachtman, 'Lessons for the GATS from Existing WTO Rules on Domestic Regulation' in Aaditya Mattoo and Pierre Sauve (eds), *Domestic Regulation and Service trade Liberalization* (World Bank, Oxford University Press, Washington 2003) 57–82.

129 For example the USA has such restrictions for communication services (radio and television broadcasters) and insurance services (in a list of States); see Mattoo and Subramanian (n 75) 1135–1164; see also Sébastien Miroudot and Alexandros Ragoussis, 'New Actors in the International Investment Scenario: Objectives, Performance and Advantages of Affiliates of State-Owned Enterprises and Sovereign Wealth

## D. THE PRE-ESTABLISHMENT PROTECTION OF SWFS' INVESTMENTS UNDER INTERNATIONAL INVESTMENT LAW

The situation concerning pre-establishment rights in International Investment Law is more straightforward, yet more fragmented. States have ratified thousands of BITs[130] and their wording varies to some extent when addressing the pre-establishment rights of foreign investors.

### 1. A Preliminary Issue: SWFs as Protected Investors

As a preliminary issue, it should be examined whether the protections of International Investment Law extend *ratione personae* to State-owned enterprises—including SWFs.

The overwhelming majority of BITs and FTAs, with only a few isolated exceptions, do contain definitions of 'investor' that cover SWFs. Indeed, some treaties expressly include 'government-owned' or 'State' enterprises,[131] some even including governments themselves,[132] while most of them simply refer to 'legal persons' as protected investors without distinguishing on the basis of the type of ownership. In fact, most investment treaties and domestic investment statutes do not exclude State-owned companies or SWFs from their broad definitions of investors and,[133] whilst some Middle Eastern BITs

Funds' in Roberto Echandi and Pierre Sauvé (eds), *Prospects in International Investment Law and Policy* (Cambridge University Press 2013) 59–60.

130 Nowadays, it is estimated that there are about 3,000 BITs in force among pairs of States where the flow of capital not only occurs in one direction; in fact, nearly a third of them are between developing States. For a more detailed account see Karl P Sauvant and Lisa E Sachs, 'BITs, DITs, and FDI Flows: An Overview' in Karl P Sauvant and Lisa E Sachs (eds), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (Oxford University Press 2009).

131 See, eg, Article 11.28, Free Trade Agreement between the United States of America and the Republic of Korea (2007); Article 1, Agreement between the Government of the United Mexican States and the Government of the People's Republic of China on the Promotion and Reciprocal Protection of Investments (2008); Articles 1(k) and 1(l), Asean Comprehensive Investment Agreement (2009); Articles 1(2) and (4), Agreement between the Government of the Republic of Korea and the Government of Japan for the Liberalization, Promotion, and Protection of Investment (2012).

132 See, eg, Article 11.28, KORUS FTA; Artice X.3, Comprehensive Economic and Trade Agreement, draft available at Foreign Affairs, Trade and Development Canada, 'Consolidated CETA Text'.

133 Examples include US, Canadian or Australian BITs; for a detailed overview see Claudia Annacker, 'Protection and Admission of Sovereign Investment under Investment Treaties' (2011) 10 Chinese Journal of International Law 531, 537–539.

expressly mention them as a class of protected investors.[134] In a relatively recent survey of 851 investment agreements, the author identified only two agreements – both with Panama – that contain any provisions that would exclude a claim by a State-owned enterprise.[135]

On a similar note, it is disputed whether the scope of application of the ICSID Convention extends to State-owned entities. Article 25(2)(b) defines as a 'national of another Contracting State […] any juridical person which had the nationality of a Contracting State […] on the date on which the parties consented to submit such dispute'. Such a definition appears to *prima facie* not exclude any State-owned entities.

Nonetheless, some authors have argued that the ICSID Convention was not designed to offer treaty protections to government agencies since it was designed to encourage 'private international investment'.[136] Consequently, they have criticised ICSID for having a liberal jurisdictional approach and for having admitted several disputes involving State-owned enterprises.[137]

Similarly, other scholars have argued that the ICSID Convention was not designed to extend to disputes that are essentially of a state-to-state nature. Therefore, the argument goes, State-owned investors ought to be excluded from the scope of the ICSID Convention when their actions can be attributable to their home State under the customary international law rules on attribution.[138]

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134 See, eg, BITs concluded by several Arab States such as Saudi Arabia, Qatar, Egypt, Kuwait and the United Arab Emirates; for a full account and examples of such Treaties see ibid 538–539.

135 See Jo En Low, 'State-controlled Entities as "Investors" under International Investment Agreements' (2012) 80 Columbia FDI Perspectives: Perspectives on Topical Foreign Direct Investment Issues by the Vale Columbia Center on Sustainable International Investment who is citing Panama BITs with Germany and Switzerland.

136 For an account of this view see Paul Blyschak, 'State-Owned Enterprises and International Investment Treaties: When are State-Owned Entities and Their Investment Protected?' (2010–2011) 6 Journal of International Law and International Relations 1, 26–27; see also International Bank for Reconstruction and Development, 'Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States' 1 ICSID Reports 25 [9] which provides that the Convention could serve 'as a major step toward promoting an atmosphere of mutual confidence and thus stimulating a larger flow of private international capital into those countries which wish to attract it'.

137 See Annacker (n 133) 556.

138 See Christopher Beus, 'Sovereign Wealth Funds in the ICSID; A New Approach to Standing' (2014) 1 Indonesia Journal of International and Comparative Law 543, 563; see also Walid Ben Hamida, 'Sovereign FDI and International Investment Agreements: Questions Relating to the Qualification of Sovereign Entities and the Admission of their Investments under Investment Agreements' (2010) 9 Law & Practice of International Courts and Tribunals 17, 25; Sonia Yeashou Chen, 'Positioning Sovereign Wealth Funds as Claimants in Investor-State Arbitration' (2013) 6 Contemporary Asia Arbitration Journal 299,

Nonetheless, Aron Broches, the 'principal architect' of the ICSID Convention, has submitted a looser test suggesting that State-owned enterprises ought to be protected under ICSID unless the State-owned entity in question is 'acting as an agent for the government' or 'discharging an essentially governmental function'.[139] In a similar vein, others have made a normative argument in favour of a more flexible and permissive approach when considering claims brought by SOEs or SWFs. For instance, it has been argued that 'in countries characterized by state capitalism, it is difficult to delineate the boundaries of the State' and, thus, a '[n]arrow construction' of jurisdiction under ICSID which would exclude claims brought by these entities could 'damage the institution's legitimacy'.[140] Notably, there is also strong support for allowing State-owned entities to access ICSID within the arbitration community.[141]

The opinion of this author is in line with the scholars arguing for a permissive jurisdictional approach. As already argued, when the ICSID Convention was designed the drafters had not envisaged the rise in SOEs and SWFs nor had they anticipated that States that pursue a more state-oriented flavour of capitalism would be integrated into a globalised trade and investment system. Additionally, it is conceptually problematic to apply the customary international law rules on attribution – which are secondary norms of international law – to issues that concern the jurisdiction of the arbitral tribunal.[142]

Therefore, it is submitted that SWFs are not only almost universally covered by the scope of application of BITs and FTAs but that, additionally, they should have access to ICSID arbitration under Article 25(2) of the Convention. The issue has not been

316; Mark Feldman, 'State-Owned Enterprises as Claimants in International Investment Arbitration' (2016) 31 ICSID Review 24, 32–34.

139 Aron Broches, *Selected Essays: World Bank, ICSID, and other Subjects of Public and Private International Law* (Martinus Nijhoff Publishers 1995) 202.

140 Ji Li, 'State-Owned Enterprises in the Current Regime of Investor-State Arbitration' in Shaheeza Lalani and Rodrigo Polanco Lazo (eds), *The Role of State in Investor-State Arbitration*, vol 3 Nijhoff International Investment Law Series (Brill/Nijhoff 2015) 402.

141 See Annacker (n 133) 556; for a more general discussion of some of the international law problems raised by multinational corporations see José E Alvarez, 'Are Corporations Subjects of International Law' (2011) 9 Santa Clara Journal of International Law 1; Joel Slawotsky, 'The Global Corporation as International Law Actor' (2012) 52 Virginia Journal of International Law Digest 79.

142 For more on this distinction, in the context of distinguishing treaty claims from contractual claims in international arbitration see James Crawford, 'Treaty and Contract in Investment Arbitration' (2008) 24 Arbitration International 351.

definitively resolved yet but the ICSID Secretariat has recently registered a claim by the SWF of Oman against Bulgaria, which will, most likely, address this issue.[143]

### 2. 'Limited Entry' and 'Liberalisation' BITs

Since SWFs would enjoy access to investment tribunals, the next issue that needs to be addressed is whether the relevant investment agreements provide for any pre-establishment rights to prospective SWF investors.

On this issue, we can broadly identify two different sets of state practice. On the one hand, we have BITs promoted mostly by European as well as developing countries. These BITs, whose origins we can trace back to the Abs-Shawcross Draft Convention – a Model BIT recommended by the OECD Council of Ministers in 1962 – lack binding provisions on the entry and establishment of foreign investors in the relevant domestic market.[144] Usually, these BITs contain a phrase that typically reads:

> Each Contracting Party shall in its territory promote as far as possible investments by investors of the other Contracting State and admit such investments in accordance with its legislation.[145]

This clause allows recipient States to escape any scrutiny of investment tribunals by enacting legislation that has the competence to block specific investments.

We can group all these investment treaties under the name 'Limited Entry BITs'. Under these agreements, States have only assumed an obligation to promote investments as far as possible but not to automatically admit all of them. The vast majority of BITs now in force have followed this approach and there seems to be a broad acceptance of their underlying rationale.[146]

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143 See *State General Reserve Fund of the Sultanate of Oman v Republic of Bulgaria* (ICSID Case No ARB/15/43).

144 See OECD, *Relationships between International Investment Agreements* (OECD Working Paper on International Investment, 2004); John M Kline and Rodney D Ludema, 'Building a Multilateral Framework for Investment: Comparing the Development of Trade and Investment Accords' (1997) 6 Transnational Corporations 1, 10.

145 For examples of this kind of clause see Article 2(1), Germany Model BIT (2008); Article 2(1)United Kingdom Model BIT (2006), Article 2(1) China Model BIT, both available in Zachary Douglas, *The International Law of Investment Claims*, vol 1 (CUP 2009) 559 and 525 respectively.

146 UNCTAD, *Admission and Establishment* (United Nations, New York and Geneva, 1999) 16, 20.

These BITs seem to reflect the idea − shared by many States − that FDI is generally welcome but remains subject to host state regulation at the point of entry.[147] The underlying rationale for such an approach is that sovereignty over economic decisions has to be affirmed and that government and private monopolies sometimes have to be protected.[148]

It is safe to assume that under these Treaties, which at the moment represent the majority of BITs in force,[149] the investment screening committees which have been set up by several States would escape the scrutiny of International Investment Law. Host States are free to block any investment they see fit or apply differential and even discriminatory treatment towards foreign investors.[150] Therefore, SWF investors that are covered by any of these Treaties would not have the opportunity to bring forth any claim in case their investments are blocked by the relevant States.

There is, however, another family of BITs that has mostly been promoted by the United States[151] and Canada and more recently by Japan, Finland and Norway. These BITs, which we can group under the title 'Liberalisation BITs', extend the national treatment obligation also to the pre-establishment stage of investments thus giving prospective investors the right to be admitted and to maintain a permanent establishment in the territory of the recipient State.[152] For instance the 2012 US Model BIT provides that:

> 1. Each Party shall accord to investors of the other Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory.

147 ibid 16, 20.

148 Gomez-Palacio and Muchlinski (n 35) 240.

149 ibid 240.

150 UNCTAD, *Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking* (United Nations, New York and Geneva, 2007) 21–22.

151 For the US Bilateral Investment Treaty Program and its instrumental role in that approach see Kenneth J Vandevelde, 'The Bilateral Investment Treaty Program of the United States' (1988) 21 Cornell International Law Journal 201.

152 See Dolzer and Schreuer (n 65) 81; Gomez-Palacio and Muchlinski (n 35) 242–245.

> 2. Each Party shall accord to covered investments treatment no less favorable than that it accords, in like circumstances, to investments in its territory of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.[153]

These BITs represented only a small fraction of the totality of BITs that had entered into force, perhaps about 4 per cent in 2005—but their number has been steadily increasing.[154] Interestingly, however, this extension of protection to the pre-establishment stage is much more common in most modern FTAs.[155] The first such Treaty that introduced that approach was the US−Canada Free Trade Agreement in 1988[156] that was later copied in the North American Free Trade Agreement and its infamous Chapter 11.[157] Other similar agreements include the FTAs concluded by Taiwan with Guatemala, Panama and Nicaragua; Korea with Chile and Singapore; Canada with Chile; Mexico with Uruguay, El Salvador, Guatemala and Honduras; Japan with Chile, Brunei, Indonesia, Malaysia, Mexico, the Philippines and Singapore and all the FTAs or Trade Promotion Agreements (TPAs) of the United States, except those with Israel and Jordan.[158] What is even more striking is that despite the fact that European countries have been reluctant to adopt a 'pre-establishment' protection type BIT in their bilateral relations, when it comes to the EU, the latter has been consistently pursuing agreements that incorporate this type of provision.[159] Indeed, the Association Agreements promoted by the European Union focus a lot on securing entry and establishment rights for foreign investors. After the Lisbon Treaty, the EU also acquired an exclusive competence over Foreign Direct Investment and there signs that it has been

153 United States 2012 Model Bilateral Investment Treaty.

154 UNCTAD, *Investor-State Disputes Arising from Investment Treaties: A Review* (2005) 31.

155 ibid 31.

156 Article 105, Canada – United States Free Trade Agreement (1988) 27 ILM 281.

157 Article 1102, North American Free Trade Agreement, 32 ILM 289, 605 (1993).

158 Molinuevo (n 101) 88.

159 ibid 87.

pursuing the incorporation of such clauses in the new FTAs (with investment chapters), as it seems to be adopting a model BIT that will largely resemble NAFTA.[160]

Furthermore, other types of agreements that have departed from the NAFTA paradigm also include pre-establishment protection. The recently ratified ASEAN Investment Protection Agreement,[161] despite the fact that it generally seeks to balance the liberalisation of investment with respect to the regulatory autonomy of the States, also provides for pre-establishment national treatment—subject to some sectoral limitations.[162] The same holds true for the MERCOSUR Colonia Protocol for the Promotion of Reciprocal Investments[163] and the Australia−Thailand FTA.[164]

The underlying economic rationale of these BITs is that optimum investment decisions are made when the State does not interfere and the economic actors make their decisions on purely economic grounds; under these, the competitive opportunities of investors, both domestic and foreign, are equalised.[165]

Typically, however, these Treaties are accompanied by a country-specific sectoral reservation list that is similar in its function to the GATS' schedules of commitments and determines the sectors to which national treatment is offered.[166]

Overall, recent developments seem to indicate that a paradigm shift is in progress in the field of BITs; the NAFTA paradigm seems to be gaining ground. This is especially true for the most recent FTAs containing investment chapters.[167] If this trend continues, it is highly likely that a significant number, perhaps the majority, of investment flows will be covered by NAFTA type BITs which grant pre-establishment rights to

160 See Nikos Lavranos, 'The New EU Investment Treaties: Convergence towards the NAFTA Model as the New Plurilateral Model BIT Text?' (2013), available at < http://ssrn.com/abstract=2241455>.

161 The Association for Southeast Asian Nations (ASEAN) is comprised of: Brunei Darussalam, the Kingdom of Cambodia, the Republic of Indonesia, the Lao People's Democratic Republic, Malaysia, the Union of Myanmar, the Republic of the Philippines, the Republic of Singapore, the Kingdom of Thailand, and the Socialist Republic of Vietnam.

162 See Articles 5 and 6, Asean Comprehensive Investment Agreement (2009).

163 See Protocol of Colonia for the Protection of Investments in Mercosur (1994).

164 See Article 904, Thailand – Australia Free Trade Agreement (2005).

165 Gomez-Palacio and Muchlinski (n 35) 243.

166 Molinuevo (n 101) 86.

167 Gomez-Palacio and Muchlinski (n 35) 251.

investors.[168] More importantly for the purposes of this thesis, however, the US already has and the EU soon will adopt this specific type of BIT. Given that SWFs at the moment seem to be investing more and more into mature developed markets, it is highly likely that in the future their investments will be covered by this type of BIT.

Interestingly, so far there have been no published disputes involving the pre-establishment stage under any of these BITs.[169] This is, however, likely to change when the potential investor is actually a very big institutional investor having the financial and political resources of a State behind it.

### 3. Foreign Investment Screening Mechanisms under 'Liberalisation BITs'

The cardinal issue for the purposes of this thesis though is whether 'investment screening mechanisms' set up by many SWF host States are actually in conformity with the 'Liberalisation' BITs.

The question is straightforward for 'Limited Entry BITs'. The *renvoi* to national law precludes any possibility of unlawfulness. Nonetheless, it is submitted that 'investment screening mechanisms' are not in conformity with 'Liberalisation' BITs. These committees *prime facie* constitute preferential treatment to domestic investors since they do not have to go through the same process in order to proceed with their investments. Sornarajah – a scholar who has in general been very sceptical towards the liberalisation of investment – also concedes that whenever the relevant BIT extends its protection to the pre-establishment stage of an investment, screening legislation will in principal not be consistent with the national treatment treaty obligations.[170] But further, any possible refusal to admit an investment would also undoubtedly violate the Treaty.

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168 Such a development could potentially have far-reaching consequences for trade policy as well.; see, eg, Emily J Blanchard, 'Reevaluating the Role of Trade Agreements: Does Investment Globalization make the WTO Obsolete?' (2010) 82 Journal of International Economics 63; Emily J Blanchard, 'Foreign Direct Investment, Endogenous Tariffs, and Preferential Trade Agreements' (2007) 7 The BE Journal of Economic Analysis & Policy who is arguing that 'as foreigners hold a greater stake in the local economy – either through direct investment or portfolio holdings – the host-government may recognize the opportunity to shift rents away from foreign owners in favor of local constituents through domestic policy changes' and that, partly as a consequence, 'preferential trade agreements may be a particularly effective means for harnessing the tariff liberalizing potential of foreign direct investment'.

169 Douglas (n 145) 141.

170 Sornarajah (n 23) 137.

## E. INTERIM CONCLUSION

The aforementioned analysis indicates that recipient States of SWFs' investments enjoy a much more limited discretion to restrict or block these investment flows than previously thought. Indeed, both the GATS and several 'NAFTA' type BITs provide potential investors in the field of services with the right to move capital in relation to an investment and to set up a permanent commercial presence in the territory of the signatories.

The foreign investment screening mechanisms that have been set up to screen and potentially block SWFs' investments have generally been given a very wide mandate which *prima facie* violates the commitments undertaken under these instruments. Admittedly, it could be argued that these committees would escape scrutiny under the 'exception' clauses contained in most of these Treaties. As will be evidenced later on, however, the wording of these clauses only allows exemption in a few, narrowly constructed circumstances related to 'national security' *stricto sensu*.

Nonetheless, this does not mean that host States should be prevented from addressing the legitimate regulatory concerns that surround the operation of SWFs within their markets—as set out in the previous Chapter. On the contrary, what will be submitted is that IEL Agreements accord host States with significant regulatory space when it comes to regulating economic entities *after* their entry into their markets.

Indeed, as will be submitted, a different conceptualisation of 'likeness' under the principle of non-discrimination, as codified in the GATS and the BIT universe, would be a better way of drawing legitimate regulatory distinctions between investors/market suppliers *after* their entry into the relevant market. The fact that SWFs possess some unique characteristics connected to their government ownership could, as a matter of law, justify this differential treatment and enable host States to regulate the operation of SWFs *differently* to other economic entities. Consequently, recipient States could differentiate the treatment they offer to SWFs on the basis of regulatory considerations, even when not invoking the relevant national security exceptions. This argument and the issue of non-discrimination in general will be examined in detail in the next chapter of this thesis.

# IV. SWFS AND LEGITIMATE REGULATORY DISTINCTIONS POST-ESTABLISHMENT

## A. INTRODUCTION

The previous section has argued that, in the case of SWFs, the crux of the matter regarding their regulation under IEL is ultimately the construction of the principle of non-discrimination. The principle is very important – and will become increasingly more relevant – to the post-establishment stage of SWFs' investments in the field of services.

Indeed, as was argued earlier, host States have legitimate regulatory concerns regarding the operation of SWFs that are not exclusively related to national security. However, host States have developed a policy whereby these issues are resolved at the 'border' through foreign investment screening mechanisms.[1] We have argued that this is an inefficient policy whilst there are problems of legality under both the GATS and several BITs and FTAs with investment chapters. Arguably, States have adopted such a policy since they are inclined to believe that once a SWF has been established in their territory, it becomes difficult to properly regulate and supervise its operation. In that context, it becomes particularly important to test the validity of such a proposition and, thus, to ascertain the balance between liberalisation and regulatory freedom—a *leitmotif* in International Economic Law.[2] In other words, the primary purpose of this Chapter is to identify the extent to which host States can draw regulatory distinctions between SWFs and other investors/market suppliers, under the relevant instruments of IEL, *after* their entry into their markets. In this context, it becomes pertinent to further develop our understanding of the principle of non-discrimination in Trade and Investment Law.

This is particularly important for two further reasons. First, SWFs as entities of a hybrid public/private nature would have the capacity to bring claims under both regimes of IEL. As a result, inconsistent approaches between the dispute settlement bodies of the

1 It is also worth noting that, in the aftermath of the 2008 financial crisis, many States have welcomed investments from SWFs. This development, however, does not constitute a solution to the issues raised previously. The relevant SWFs' investments went forth − in an environment arguably desperate for investment − without the host States having addressed the regulatory issues that concern their operation within their market. The situation remains quite static at the moment but it most probably resembles the 'calm before the storm'. Once the global economy fully stabilises and/or SWFs begin to pursue more active investment strategies, there is likely to be a political backlash that will force the host States to deal with the issue.

2 John H Jackson, *World Trade and the Law of GATT* (Michie Company Law Publishers 1969) 788; see also Catharine Titi, *The Right to Regulate in International Investment Law*, vol 10 (Bloomsbury Publishing 2014).

two regimes are not unlikely. Second, the scopes of application of the GATS and most BITs overlap to a significant extent when it comes to international investment in the field of services. In fact, this could be described as a 'normative overlap' between the provisions of these agreements. Thus, SWFs constitute the perfect conceptual canvas for drawing a more vivid picture of the principle of non-discrimination in the field of International Economic Law *in toto*.

The popular view used to be – at least until the advent of the GATS and Mode 3 Trade in Services – that International Trade and International Investment Law are like 'ships passing in the night'. The hypothesis of this chapter, on the contrary, is that the partial normative overlap between them ought to have certain normative consequences. Therefore, we will perform a comparative and contextual exercise between the GATT, the GATS[3] and International Investment Law that will reveal that there is no substantive fragmentation between the regimes when it comes to the regulation of the same economic transactions and actors. Such an approach is sanctioned by the case law of the WTO since, as the Appellate Body has pronounced in the context of interpreting the notion of 'likeness', a case-by-case analysis is the appropriate method for interpreting similar provisions across the WTO agreements.[4] Ultimately, it will become apparent that such an interpretation will provide a consistent standard for the regulation of Mode 3 trade and investment in services.

This uniform interpretation will allow Member States to draw regulatory distinctions between SWFs and other service suppliers and investors operating within their market providing them with enough freedom to address their concerns through regulation *behind the border*. Consequently, such an approach incentivises States to admit SWFs' investments − thus, promoting efficiency − without having to 'mask' their regulatory concerns as national security questions.

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3 For an argument in support of a GATT/GATS comparative methodology see, eg, *US – Section 211 Appropriations Act* WTO Appellate Body, United States – Section 211 Omnibus Appropriations Act of 1998, WT/DS176/AB/R, adopted 1 February 2002, DSR 2002:II, 589 [242].

4 *Japan – Alcoholic Beverages II* WTO Appellate Body, Japan – Taxes on Alcoholic Beverages, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97, 21; see however Petros C Mavroidis, 'Legal Eagles? The WTO Appellate Body's First Ten Years' in Merit Janow, Victoria Donaldson and Alan Yanovich (eds), *The WTO: Governance, Dispute Settlement, and Developing Countries* (Juris Publishing, Huntington NY 2008) 360 who has pointed out that 'a case-by-case analysis does not make the need for methodology redundant'.

## B. Functional And Contextual Similarities Between The Trade And Investment Regimes

Traditionally, as we mentioned, the prevalent view on similar standards of treatment across (or sometimes even within) trade and investment law has been that, *in principle*, interpretations from one field are not directly relevant – let alone transposable − to others. More specifically, it has been suggested that the different objectives that non-discrimination obligations seek to achieve, the vertical as opposed to the horizontal nature of the rules, the different remedies the parties have, as well as the context of these agreements suffice to render the regimes incomparable.[5]

In this thesis, however, it is submitted that – in line with other scholars – there is a lot of merit in attempting to comparatively approach similar standards of treatment across regimes.[6]

First of all, several of these claims have been refuted or had their significance diminished. For instance, the argument that trade law focuses on macro-objectives such as market access and trade opportunities to increase overall welfare whilst investment law focuses on micro-objectives such as promoting foreign investment of individuals[7] is

5 See Nicholas DiMascio and Joost Pauwelyn, 'Non-Discrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?' (2008) 102 American Journal of International Law 48, 53 who have argued that 'trade objectives focus on macro-issues, such as increasing the overall welfare through exchanging trade concessions and market opportunities (in particular through the elimination of discrimination), whereas investment rules are aimed to achieve only micro-objectives, namely the protection of individual investments against discrimination'; see also Joel P Trachtman, 'FDI and the Right to Regulate: Lessons from Trade Law' in UNCTAD The Development Dimensions of FDI: Policy and Rule-Making (2003) 189 available at <http://www.unctad.org/en/docs/iteiia20034_en.pdf>; Todd Weiler, *The Interpretation of International Investment Law: Equality, Discrimination and Minimum Standards of Treatment in Historical Context* (Martinus Nijhoff Publishers 2013) xliv who argues that the GATT was the outcome of an international consensus in favour of state planning whilst BITs were the product of liberal officials and entrepreneurs.

6 For a laudable attempt at drawing analogies and comparing the principles of non-discrimination across trade, investment and human rights law see Freya Baetens, 'Nationality Based Discrimination in Public International Law with Specific Focus on Human Rights, Trade and Investment Law' (PhD thesis, University of Cambridge 2009); for a most recent comprehensive monograph on this subject see Jürgen Kurtz, *The WTO and International Investment Law: Convergent Systems* (Cambridge University Press 2016); for scholars also arguing for more integration between the two regimes see Mary E Footer, 'On the Laws of Attraction: Examining the Relationship Between Foreign Investment and International Trade' in Roberto Echandi and Pierre Sauvé (eds), *Prospects in International Investment Law and Policy* (Cambridge University Press 2013); Tomer Broude, 'Investment and Trade: the "Lottie and Lisa" of International Economic Law?' in Roberto Echandi and Pierre Sauvé (eds), *Prospects in International Investment Law and Policy* (Cambridge University Press 2013); Rudolf Adlung, 'International Rules Governing Foreign Direct Investment in Services: Investment Treaties versus the GATS' (2016) 17 The Journal of World Investment & Trade 47.

7 DiMascio and Pauwelyn (n 5) 53.

too superficial; arguably, trade law also seeks to achieve micro-objectives such as preventing powerful domestic companies from blocking the entrance of competitive foreign competitors in the market[8] whilst it has been acknowledged that it also indirectly protects the rights of private economic operators.[9] Conversely, many BITs contain provisions that stipulate that investment protection and promotion should be pursued in line with of other macro objectives such as the protection of health, safety and consumer rights.[10] *A minore ad maius*, it has even been suggested that trade and investment law display remarkable commonalities with human rights law and its objectives.[11]

Furthermore, the argument that trade law is substantially different due to the fact that the non-discrimination obligations it imposes concern inter-state relations whilst investment law directly applies to discrimination against individuals is only partially accurate. Arguably, the exact nature of the rights of individuals under WTO and Investment Law does not substantially affect the substantive nature of the non-discrimination assessment exercise.[12] In any case, the relevant obligations are imposed

8 See Per Norberg, 'Non-Discrimination as a Social and a Free-Market Value' in Ann Numhauser-Hennig (ed), *Legal Perspectives on Equal Treatment and Non-Discrimination* (Kluwer Law International 2001) 71 who defines the core meaning of the legal concept of non-discrimination – albeit in the context of EU trade law – as preventing

> groups or companies that have achieved a powerful position in the market from closing that market and blocking the entrance of more competent competitors who might challenge their position. The one they want to shut out is unfavourably treated in comparison with the members inside the group. This is the core meaning of the legal concept of discrimination.

9 See *US – Sections 301-310 of the Trade Act of 1974* WTO Panel Report, WT/DS152/R, adopted 27 January 2000, DSR 2000:II, 815 [7.77]–[7.78]:

> Trade is conducted most often and increasingly by private operators. It is through improved conditions for these private operators that Members benefit from WTO disciplines. The denial of benefits to a Member which flows from a breach is often indirect and results from the impact of the breach on the market place and the activities of individuals within it.

10 See Freya Baetens, 'Discrimination on the Basis of Nationality: Determining Likeness in Human Rights and Investment Law' in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (Oxford University Press 2010) 34−37 who offers a comprehensive list of BITs containing clauses promoting other macro-objectives.

11 See Ernst-Ulrich Petersmann, *Constitutional Functions and Constitutional Problems of International Economic Law: International and Domestic Foreign Trade Law and Foreign Trade Policy in the United States, the European Community and Switzerland (translation into Chinese)* (Higher Education Press 2004) 225 *et seq*.

12 See Baetens, 'Discrimination on the Basis of Nationality: Determining Likeness in Human Rights and Investment Law' (n 10) 40–42.

upon States in both regimes. Moreover, the position of individuals across different subsystems of trade law is not uniform. As it will be evidenced later on, the treatment of traders in the field of services under the GATS is much more akin to the status of investors as indirect beneficiaries of substantive rights in Investment Law[13] and this will constitute a further argument in favour of drawing analogies between the two subsystems.

Admittedly, the architecture of the respective dispute settlement mechanisms and the remedies they offer are indeed different. This should not, however, have any direct bearing on the substantive interpretation of the non-discrimination obligations.[14] Furthermore, in light of actors such as SWFs that are not only covered by the substantive field of application of both regimes but also have access to both dispute settlement mechanisms,[15] the significance of these differences further diminishes.

Another argument that has been put forth[16] to justify differences in the interpretation of non-discrimination obligations across trade and investment law is that there is less political pressure to keep investment out of a market given that sector-specific labour will be less opposed to it.[17] True as this might be, albeit disputed,[18] it does not logically

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13 There is still an unsettled debate about whether investors are direct or indirect beneficiaries of substantive rights under BITs. For a proponent of the 'direct rights' approach see Andrew Paul Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer law international 2009) 511; for notable scholars in support of the proposition that the rights of investors are of an 'indirect' or 'derivative' nature' see Zachary Douglas, *The International Law of Investment Claims*, vol 1 (CUP 2009) 11 *et seq*.; Anastasios Gourgourinis, 'Investors' Rights Qua Human Rights? Revisiting the 'Direct/Derivative' Rights Debate' in Malgosia Fitzmaurice and Panos Merkouris (eds), *The Interpretation and Application of the European Convention of Human Rights: Legal and Practical Implications*, vol 12 (Martinus Nijhoff Publishers 2012) 147.

14 Baetens, 'Discrimination on the Basis of Nationality: Determining Likeness in Human Rights and Investment Law' (n 10) 41.

15 Technically, SWFs would only have independent access to arbitral *fora* provided for under the relevant BITs and not the WTO dispute settlement system. However, given the fact that SWFs are ultimately controlled by the respective home State, this distinction between States and private individuals breaks down. Indeed the controlling State would arguably be more likely to resort to the WTO dispute settlement system to defend its SWF than it would for any other individual service supplier/investor.

16 DiMascio and Pauwelyn (n 5) 56.

17 See Bernard Hoekman and Carlos A Primo Braga, 'Protection and Trade in Services: A Survey' (1997) 8 Open Economies Review 285, 306 who argue that it is 'generally assumed that sector-specific factors of production employed in inefficient protected industries will oppose liberalization of market access' whereas, with regards to FDI in the services industry, that 'this may not be the case [since] to the extent that establishment is the most efficient mode of contesting a service market, sector-specific labor may be less opposed to liberalization, insofar as it is expected that net employment in the sector concerned will not change much upon liberalization due to the establishment of foreign-owned firms'; see also Trachtman (n 5) 191−192.

follow that the different political perception of these factors of production should influence the way the principle of non-discrimination is interpreted. In fact, despite the aforementioned hypotheses, there seems to be a stronger backlash against the investment regime than the GATS or the WTO in general.[19]

Therefore, the aforementioned objections are not credible enough to render such a comparative exercise futile. Indeed, it is probably more likely that the explanation of these regulatory divergences rather lies in the existence of historical and political economy reasons. Today though, in the context of a globalised and integrated economy, this distinction is rather difficult to justify.[20]

In contradistinction, there are strong arguments in favour of a more 'integrated' interpretation of similar notions across these different subsystems of IEL. First of all, from an economics perspective, both areas are concerned with the efficient allocation of resources and, as a consequence, with the facilitation of economic efficiency through international economic activity; in that sense, the economic theory of comparative advantage is applicable to both.[21]

Furthermore, the two agreements very often use similar – if not identical – textual formulations to describe standards of treatment—the case in point being the principle of non-discrimination.[22] Even when the texts do differ, there is strong support for the proposition that the substance of the treatment is, in essence, quite similar.[23]

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18 Baetens, 'Nationality Based Discrimination in Public International Law with Specific Focus on Human Rights, Trade and Investment Law' (n 6) who makes the argument that 'foreign investment might just as well create more political unrest than trade, since it establishes a more permanent foreign-controlled presence on the economic market, whereas trade merely brings in a number of goods which are 'used and gone'.

19 See Michael Waibel and others (eds), *The Backlash against Investment Arbitration: Perceptions and Reality* (Kluwer Law International 2010); Gus Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford University Press 2007); see also Muthucumaraswamy Sornarajah, 'Right to Regulate and Safeguards' (UN Conference on Trade & Development, The Development Dimensions of FDI: Policy and Rule-Making Perspectives 189, UN Doc UNCTAD/ITE/IIA/2003/4, New York, 7−8 December 2009) who has argued that '[t]he granting of rights to foreign investment is necessarily more erosive of the sovereignty of the host State than are rights granted in connection with international trade […] [since it] is an activity that takes place within the borders of a State'.

20 Broude (n 6) 140.

21 ibid 141.

22 For a detailed overview, see Adlung (n 6) 54−61.

23 See, eg, Andrew D Mitchell, Elizabeth Sheargold and Tania Voon, 'Good Governance Obligations in International Economic Law: A Comparative Analysis of Trade and Investment' (2016) 17 The Journal of World Investment & Trade 7.

Moreover, there is considerable normative overlap between the GATS and the International Investment regime. Mode 3 of the GATS is in essence a discipline of liberalising investment. In that context, the very same economic activity – eg, a financial enterprise establishing a subsidiary abroad – if it both satisfies the relevant definition of 'investment' and is considered a service[24] will be covered by both trade law and investment law.[25] This became strikingly clear when, after the entry into force of the GATS, several Members chose to list specific sectoral commitments under Mode 3 in accordance with their domestic laws on FDI and/or their bilateral treaty obligations.[26] Notably, an investment tribunal recently upheld *prima facie* jurisdiction and ordered provisional measures relying on the GATS MFN provision despite refusing to address the issue in great detail—thus verifying such a normative overlap.[27]

The significance of this normative overlap is further augmented by the fact the there is a constantly increasing FDI flow in services sectors.[28] According to some statistics, FDI 'has become more important than trade for delivering goods and services to foreign markets'.[29]

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24 It is even argued that from a balance of payments perspective, the supply of a service by an entity resident in the consumer's territory is a transaction between residents and is therefore not recorded as a trade transaction but as an investment; see Mary E Footer and Carol George, 'The General Agreement on Trade in Services' in Patrick FJ MacRory, Arthur E Appleton and Michael G Plummer (eds), *The World Trade Organization: Legal, Economic and Political Analysis* (Springer 2005) 825.

25 Bart De Meester and Dominic Coppens, 'Mode 3 of the GATS: A Model for Disciplining Measures Affecting Investment Flows?' in Zdenec Drabek and Petros C Mavroidis (eds), *Regulations of Foreign Investment: Challenges to International Harmonization* (World Scientific Publishing Company Incorporated 2013) 107; Broude (n 6) 147; See also Gaëtan Verhoosel, 'The Use of Investor–State Arbitration under Bilateral Investment Treaties to Seek Relief for Breaches of WTO Law' (2003) 6 Journal of International Economic Law 493 who is arguing that WTO law could either be applicable to an investment dispute or, in the alternative, could constitute interpretative context for the regulatory treatment obligations of the BIT; see also Brooks E Allen and Tomaso Soave, 'Jurisdictional Overlap in WTO Dispute Settlement' in Jorge Alberto Huerta-Goldman, Antoine Romanetti and Franz X Stirnimann (eds), *WTO Litigation, Investment Arbitration, and Commercial Arbitration* (Kluwer Law International 2013) 45, 75 who is arguing that a foreign investor might use a WTO violation as a predicate to a BIT claim.

26 Rudolf Adlung and others, *Fog in GATS Commitments–Boon or Bane?* (World Trade Organization: Staff Working Paper, ERSD-2011-04, 2011) 10–11.

27 See *Menzies Middle East and Africa SA and Aviation Handling Services International Ltd v Republic of Senegal* (ICSID Case No ARB/15/21) Procedural Order No 2, 2 December 2015 [108]−[113].

28 UNCTAD, *World Investment Report 2004 – The Shift to Services* (United Nations, New York, 2004) Chapter III.

29 Karl P Sauvant, 'New sources of FDI: the BRICs – Outward FDI from Brazil, Russia, India and China' (2005) 6 Journal of World Investment and Trade 639, 639.

This, however, does not automatically mean that there should be a uniform interpretation across all relevant treaties. The text of the treaty should always be the starting point of any interpretation informed by the context as well as the object and purpose of the relevant agreement. However, the aforementioned factors render the object and purpose as well as the context of these agreements quite similar: the promotion of 'growth and development through favourable transparent and predictable conditions for trade and investment'.[30] If this is read in conjunction with the textual similarity of the non-discrimination provisions, there is a strong case for substantial cross-fertilisation in the substantive interpretation of the non-discrimination obligations. In any case, there are arguably significant learning effects stemming from this exercise even if we conclude that the differences in objectives reduce this comparison to redundancy.

Indeed, it will be suggested that a proper conceptualisation of the principle should rely heavily on the context at the back of which the agreements that codify the principle were negotiated. Furthermore, due attention should be accorded to the economic function of the transactions that these agreements seek to regulate. The method of strict textual interpretation and the resort to dictionary definitions has already proved its limits, as advocated by several scholars.[31] In that context, it will be submitted, that not only a cross-fertilisation would be welcome but that even a unified analysis of certain issues is imperative for the proper function of both regimes.

## C. THE PRINCIPLE OF NON-DISCRIMINATION IN IEL – RATIONALES, FUNCTION AND LEGITIMATE REGULATORY DISTINCTIONS

### 1. Introduction

In this section of the chapter, we will provide a brief overview of the principle of non-discrimination across IEL along with an explanation of its economic and political rationales as well as its function across the board. This will further elucidate the function

30 Adlung (n 6) 51.

31 For instance, see Federico Ortino, 'Treaty Interpretation and the WTO Appellate Body Report in US–Gambling: A Critique' (2006) 9 Journal of International Economic Law 117, 147 who states that ' […] this is the argument advanced in this paper, it is the textuality which is qualified in a variety of important ways, for example by giving meaning to the terms of the treaty in their context and in the light of its object and purpose'; see also Asif H Qureshi, *Interpreting WTO agreements: Problems and Perspectives* (Cambridge University Press 2006) 4 *et seq*.

of the principle and allow us to contextualise and draw analogies between different agreements—irrespective of the *factor of production* they concern.

### 2. Economic and Political Rationales

The principle of non-discrimination is of cardinal importance in the field of IEL and has been described as its 'central pillar'[32] and one of the chief objectives of the WTO.[33] Oppenheim has aptly defined the general notion in international law by arguing that 'discrimination may in general be said to arise where those who are in all material respects the same are treated differently, or where those who are in all material respects different are treated in the same way'.[34]

Understanding the rationale underlying the principle of non-discrimination is essential for its interpretation since these instruments serve a particular object and purpose, the one the drafters of these instruments envisaged, and this has to be taken into account in their construction.[35]

Several scholars agree that a political and an economic purpose lie behind the principle of non-discrimination.[36] On the economic front, it has been argued that the maximisation of economic efficiency is one of its most important functions.[37] Consequently, there is a widespread belief that discrimination is undesirable *as such* in economic relations. Its absence, the argument goes, facilitates economic growth and prosperity by enabling a more efficient allocation of resources between producers, to the benefit of everyone. Accordingly, all countries can benefit from feely trading with each

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32 Nicolas F Diebold, 'Standards of Non-Discrimination in International Economic Law' (2011) 60 International and Comparative Law Quarterly 831, 831; see also Steve Charnovitz, 'What Is International Economic Law' (2011) 14 Journal of International Economic Law 3.

33 Marrakesh Agreement Establishing the World Trade Organization, April 15, 1994, 1867 UNTS 154, 33 ILM 1144, Clause 3, Preamble.

34 Robert Yewdall Jennings and Sir Arthur Watts (eds), *Oppenheim's International Law* (Longman Harlow 1992) 378.

35 In accordance with Article 31 VCLT; see Petros C Mavroidis, *Trade in Goods: the GATT and the other Agreements Regulating Trade in Goods* (Cambridge University Press 2008) 6.

36 See Ernst-Ulrich Petersmann, 'Economic, Legal and Political Functions of the Principle of Non-discrimination' (1986) 9 Journal of World Trade 113, 117–118; Michael Trebilcock, Robert Howse and Antonia Eliason, *The Regulation of International Trade* (Routledge, Oxford 2012) 51; John Howard Jackson, *The World Trading System: Law and Policy of International Economic Relations* (2nd edn, The MIT press, Cambridge, MA 1997) 158 *et seq*.; Newcombe and Paradell (n 13) 147–148.

37 Jagdish N Bhagwati, *The World Trading System at Risk* (Princeton University Press 1991) 50–51; Kyle Bagwell and Robert W Staiger, *The Economics of the World Trading System* (MIT Press 2004) 24.

other, even if they do not enjoy *any* absolute advantage over their competition—as was first pointed out by Ricardo in his theory of comparative advantage.[38] The same reasoning applies by analogy to the allocation of other factors of production, such as services and capital.

This portrayal of the principle is rather simplified however; in fact, there are several scenarios under which discrimination can be welfare maximising or socially desirable.[39] Additionally, there is evidence that it is the form of discrimination that matters the most and not discrimination *per se*.[40] Nevertheless, and despite these caveats, there is evidence that the existence of the principle lends stability to the international trading system, promotes multilateral trade liberalisation[41] − by allowing the extension of the benefit accruing from multilateral negotiations to everyone −[42] and reduces the costs of both the trade negotiations and of the administration of tariffs.[43]

Furthermore, it has been argued that the principle of non-discrimination serves an important political function and constitutes a stabilising force in the world geopolitical system. Namely, the economic interdependence that develops between States in a liberalised economic system tends to reduce antagonism and, as a consequence, enhance

38 See David Ricardo and Ronald Max Hartwell, *On the Principles of Political Economy and Taxation*, vol 165 (Penguin Books Harmondsworth 1971).

39 See Henrik Horn and Petros C Mavroidis, 'Economic and Legal Aspects of the Most-Favored-Nation Clause' (2001) 17 European Journal of Political Economy 233, 234 who mention relevant examples in the economic literature.

40 See ibid 244 *et seq.*; see also Harry Johnson, 'Trade Negotiations and the New International Monetary System' in Gerard Curzon and Victoria Gurzon (eds), *Commercial Policy Issues* (AW Sijthoff, Leiden 1976) who has gone as far as suggesting that–

> the principle of nondiscrimination has no basis whatsoever in the theoretical argument for the benefits of a liberal international trade order in general, or in any rational economic theory of the bargaining process in particular.

41 For an overview of the economic literature supporting these claims see Horn and Mavroidis (n 41) 251–263.

42 See *Canada – Certain Measures Affecting the Automotive Industry* WTO Appellate Body, WT/DS139/AB/R, WT/DS142/AB/R, adopted 19 June 2000, DSR 2000:VI, 2985 [84] which stated that the object and purpose of the obligation on MFN treatment is not only to prohibit discrimination between products originating from different countries, but that it also 'serves as an incentive for concessions, negotiated reciprocally, to be extended to all other Members on an MFN basis'.

43 See Jacob Viner, 'The Most-Favored-Nation Clause, Index VI' (1931) Sevenka Handelsbanken, Stockholm (reprinted as Chapter 5 of International Economics, The Free Press, Glencoe, III, 1951).

stability and ensure peace.[44] The MFN principle especially is designed to constraint sovereigns from implementing short-term *ad hoc* trade policies for political considerations [45] thus also reducing international antagonism [46] and promoting cooperation between nations.[47] This same idea underpinned the creation of the EU and is still present today in the notion of 'ever closer Union'.[48]

These rationales are highly informative of the exact construction of the principle. Nonetheless, its highly contextual nature renders its proper construction − along with its constitutive elements − quite elusive, complex and controversial. As a result, we are nowhere near close to a *jurisprudence constante* not even within the WTO,[49] let alone a general theory of non-discrimination in International Law.

### 3. Manifestations of the Principle

The two most important manifestations of the principle of non-discrimination are the Most-Favoured Nation and National Treatment provisions. In a nutshell, as

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44 This axiom has been iterated by the US Secretary of State Cordell Hull who, in the aftermath of World War II, famously noted that:

> I have never faltered, and I will never falter, in my belief that enduring peace and the welfare of nations are indissolubly connected with friendliness, fairness, equality and the maximum practicable degree of freedom in international trade.

Cordell Hull and Andrew Henry Thomas Berding, *The Memoirs of Cordell Hull*, vol 1 (Macmillan New York 1948) 75; see also William J Davey and Joost Pauwelyn, 'MFN Unconditionality: A Legal Analysis of the Concept in View of its Evolution in the GATT/WTO Jurisprudence with Particular Reference to the Issue of "Like Product"' in Thomas Cottier and Petros C Mavroidis (eds), *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law*, vol 13 (University of Michigan Press, Ann Arbor 2000) 15.

45 Jackson (n 36) 159.

46 See Reports of the Commission to the General Assembly, (1969) 2 Yearbook of International Law Commission 157, 163; Warren F Schwartz and Alan O Sykes, 'Toward a Positive Theory of the Most Favored Nation Obligation and its Exceptions in the WTO/GATT System' (1996) 16 International Review of Law and Economics 27, 41.

47 See Hull and Berding (n 44).

48 See Article 1, Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community OJ C 306, 17 December 2007 which provides that '[t]his Treaty marks a new stage in the process of creating an ever closer union among the peoples of Europe, in which decisions are taken as openly as possible and as closely as possible to the citizen'.

49 See, eg, Henrik Horn and Petros C Mavroidis, 'Still Hazy After All These Years: The Interpretation of National Treatment in the GATT/WTO Case-law on Tax Discrimination' (2004) 15 European Journal of International Law 39; Won-Mog Choi and Freya Baetens, 'Like Products' in Rüdiger Wolfrum (ed), *Max Planck Encyclopedia of Public International Law*, vol 11 (Oxford University Press 2013).

Schwarzenberger has succinctly observed, the MFN's objective is 'foreign parity', whereas the NT's objective is 'inland parity'.[50] Manifestations of these principles can be found in a significant number of IEL instruments, the most important (for the purposes of this research) being Articles I and III of the GATT,[51] Article 2.1 TBT, Articles II and XVII of the GATS[52] as well as Articles 1102, 1103, 1202 and 1203 of the NAFTA.[53]

The Most-Favoured Nation Principle in its archetypical form has been defined as−

> […] treatment accorded by the granting State to the beneficiary State, or to persons or things in a determined relationship with that State, not less favourable than treatment extended by the granting State to a third State or to persons or things in the same relationship with that third State.[54]

It has been described as 'one of the cornerstones of the world trading system'[55] and, in a nutshell, provides that a State shall not discriminate between its different trading partners. It is probably the oldest principle in the international trading order and its origins can arguably be traced even as far back as the 11th century[56] whilst its first formulation in its current form appears at the end of the 17th century.[57]

Correspondingly, in its general form, NT provides that:

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50 Georg Schwarzenberger, 'The Most-Favored-Nation Standard in British State Practice' (1945) 22 British Yearbook of International Law 96, 119.

51 General Agreement on Tariffs and Trade 1994, April 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, The Legal Texts: the Results of the Uruguay Round of Multilateral Trade Negotiations 17 (1999), 1867 UNTS. 187, 33 ILM 1153 (1994) ) ('GATT').

52 General Agreement on Trade in Services, April 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, The Legal Texts: the Results of the Uruguay Round of Multilateral trade Negotiations 284 (1999), 1869 UNTS 183, 33 ILM 1167 (1994) ('GATS').

53 North American Free Trade Agreement, 32 ILM 289, 605 (1993).

54 Article 4, 'ILC Draft Articles on MFN' (1978) II Yearbook of the International Law Commission16, 16 *et seq*.

55 Arguably, these days MFN has lost some of its significance given that most trade is conducted in non-MFN terms due to the proliferation of Preferential Trade Agreements (PTAs); for empirical research on this point see André Sapir, 'The Political Economy of EC Regionalism' (1998) 42 European Economic Review 717; Jeffrey J Schott, 'More Free Trade Areas?' in Jeffrey J Schott (ed), *Free Trade Areas and US Trade Policy* (Institute of international Economics, Washington DC 1989) 1.

56 The principle can be traced back to the 11th century when the Emperor of the Roman Holy Empire assured the city Mantua in Lombardy that 'all customs privileges granted to whatsoever other town' will be granted to the city too. See Le Baron B Nolde, 'La Clause de la Nation la Plus Favorisée et les Tarifs Preferentiels' (1932) 39 Recueil des Cours de l'Academie de Droit International 25.

57 Jackson (n 36) 158.

> National treatment means treatment by the granting State of persons or things in a determined relationship with the beneficiary State, not less favourable than treatment of persons or things in the same relationship with itself.[58]

The rationales behind each manifestation of the principle vary to an extent. For instance, the economic rationale of the principle, as codified in the GATT, is primarily the reduction of tariffs and an undertaking to not use 'internal policy measures in a protectionist fashion'.[59] Arguably, however, the same reasoning could be applied to all international treaties containing MFN and NT provisions; they constitute a safeguard mechanism against undermining an international agreement through taxation or any other domestic regulation. Under the GATS or Investment Law, however, where border measures are inconceivable, the rationale mainly concerns the guarantee of market access and the elimination of protectionism.

Another important aspect of these provisions is that they were not envisaged as instruments of deregulation. The NT obligation, for instance, extends to regulatory interventions of both fiscal and non-fiscal nature[60] but the GATT and GATS are negative integration contracts. In that sense, 'NT means that WTO members can *unilaterally* define their domestic policies and, to the extent that there is negative trans-boundary spill-over stemming from this exercise, it will be internalized through the obligation not to discriminate across domestic and foreign products'.[61] The same can be said of the NAFTA or other BITs since they were never designed with the purpose of implementing common policies (unlike the EU for instance) but rather as agreements that will guarantee market access and a minimum standard of treatment for foreign investors.

In that sense, treaties containing a NT obligation are incomplete since they cover all domestic instruments capable of affecting trade in goods, services or investment without naming them explicitly. This further exacerbates the problem of interpretation since

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58 'ILC Fifth Report on MFN' (1974) II Yearbook of the International Law Commission 1, 124.

59 Horn and Mavroidis, 'Still Hazy After All These Years: The Interpretation of National Treatment in the GATT/WTO Case-law on Tax Discrimination' (n 49) 40.

60 See *Japan – Alcoholic Beverages II (AB)* (n 4) 17 which noted that:

> [T]he Article III national treatment obligation is a general prohibition on the use of internal taxes and other internal regulatory measures so as to afford protection to domestic production.

61 Mavroidis, *Trade in Goods: the GATT and the other Agreements Regulating Trade in Goods* (n 61) 215.

Members often possess private information about their intended objectives and can, through regulation, pursue objectives that are inconsistent with the spirit of these agreements.[62] This is the crux of the matter when applying the principle of non-discrimination and the most important challenge for the purposes of this thesis: identifying host State protectionist policies despite the significant informational asymmetries.

### 4. De Facto Discrimination and Regulatory Distinctions

A further conceptual difficulty accompanying the principle of non-discrimination and its interpretation is that the principle covers both *de jure* as well as *de facto* discrimination.[63] *De jure* discrimination is defined as the situation where the relevant State uses a formal instrument or pursues an informal practice that differentiates between two objects of treatment explicitly on the basis of their nationality. Conversely, *de facto* discrimination is not aimed directly at their foreign object of treatment but rather has the effect of producing an adverse effect to it.[64]

Given that, so far, host States have not enacted any domestic policies explicitly discriminating against SWFs *on the basis of their origin*,[65] this chapter will focus on an

62 ibid 192.

63 It is not necessary and, in fact, most provisions do not explicitly mention that their scope covers both these types of discrimination. However, it is accepted in practice that – unless otherwise specified – non-discrimination provisions cover both types of discrimination. For instance, see *Canada – Autos (AB)* (n 42) [10.40]–[10.78] where, in the context of interpreting Article I GATT it was stated that:

> [W]e observe first that the words of Article I:1 do not restrict its scope only to cases in which the failure to accord an 'advantage' to like products of all other Members appears on the face of the measure, or can be demonstrated on the basis of the words of the measure. Neither the words 'de jure' nor 'de facto' appear in Article I:1. Nevertheless, we observe that Article I:1 does not cover only 'in law', or de jure, discrimination. As several GATT panel reports confirmed, Article I:1 covers also 'in fact', or de facto, discrimination. Like the Panel, we cannot accept Canada's argument that Article I:1 does not apply to measures which, on their face, are 'origin-neutral'; in the context of international investment law it is universally accepted that non-discriminatory treatment covers both de jure and de facto discrimination as suggested by the wording of pretty much all BITs.

64 Some authors distinguish between *de jure* and direct as well de *facto* and indirect discrimination; see Baetens, 'Nationality Based Discrimination in Public International Law with Specific Focus on Human Rights, Trade and Investment Law' (n 6) 83 who defines de *jure* discrimination as one which involves the use of a formal instrument (eg, legislation) and *de facto* which only involves an informal practice. For the purposes of this thesis however, we will be following the WTO case law that tends to equate these terms.

65 It should, however, be kept in mind that in the case of China, specific provisions of its Protocol of Accession to the WTO might apply in situations where its SWFs are involved. At the very least, the

analysis of the principle of non-discrimination in situations involving origin-neutral measures. In any case, it is accepted that *de jure* discrimination is relatively easy to assess under WTO/investment law as both elements of 'less favourable treatment' and 'likeness' would normally be present. For that reason, WTO law, for instance, treats instances of *de jure* discriminations as *prima facie* illegal or as creating a presumption of illegality.[66]

The extension of the scope of application of these provisions to cover situations of *de facto* discrimination has been described as opening Pandora's Box[67] and constitutes both a conceptual and factually difficult exercise. Measures amounting to *de facto* discrimination tend to take the form of internal taxes and domestic regulation which differentiate on the basis of factual circumstances related to the product/service, the production method or the market place, resulting in 'tilting the scales' against the imported products or services.[68]

Ascertaining *de facto* discrimination is easier when it comes to measures that are factually impossible to comply with or impose high transactions costs that again render

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Protocol could offer host States of SWF investments the ability to implement certain safeguards under the Protocol.

66 See *Korea – Various Measures on Beef* Panel Report, Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef, WT/DS161/R, WT/DS169/R, adopted 10 January 2001, as modified by Appellate Body Report WT/DS161/AB/R, WT/DS169/AB/R, DSR 2001:I, 59 [627] which proclaimed that−

> [a]ny regulatory distinction that is based exclusively on criteria relating to the nationality or the origin of the products is incompatible with Article III [...] confirming that there is no need to demonstrate the actual and specific trade effects of a measure for it to be found in violation of Article III. The object of Article III:4 is, thus, to guarantee effective market access to imported products and to ensure that the latter are offered the same market opportunities as domestic products

See however *Korea – Various Measures on Beef* Appellate Body Report, Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef, WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001, DSR 2001:I, 5, [137]–[138] on the same case which decided that such a standard would probably be too cumbersome and explicitly rejected it by pronouncing that−

> [w]hether or not imported products are treated 'less favourably' than like domestic products should be assessed [...] by examining whether a measure modifies the *conditions of competition* in the relevant market to the detriment of imported products (emphasis added).

67 Mavroidis, *Trade in Goods: the GATT and the other Agreements Regulating Trade in Goods* (n 61) 127.

68 John H Jackson, 'National Treatment Obligations and Non-tariff Barriers' (1989) 10 Michigan Journal of International Law 207, 212.

compliance impossible.[69] The situation, however, becomes much more blurry when it comes to measures which are, on the whole, equally burdensome on both domestic and foreign producers/suppliers/investors but, under certain circumstances, they impact some imports/services/investments much more frequently or much more intensely than domestic goods or services.

Indeed, as was explained, none of the IEL agreements was envisioned as an instrument of deregulation. Therefore, measures that have *the effect* of adversely impacting imported products/services/investments shall not be found to be unlawful provided they pursue a legitimate policy. This is due to the fact that Members States ought to be able of drawing legitimate regulatory distinctions without violating the principle. Several different tests and standards have been proposed to strike the right balance between these competing goals under different agreements or even within the principle itself and they will be analysed further on.

## D. Non-discrimination and Regulatory Distinctions Under The GATT and TBT

### 1. Introduction

In the following parts, we will provide a summary of the debates surrounding these notions in the context of trade in goods under the GATT and TBT Agreements. The interpretation of the principle and its different manifestations is far from being clear or undisputed; in fact, as has been suggested, 'after all these years, we are still in the dark as to the precise ambit of what has been described time and again as the "cornerstone" of the GATT edifice'.[70] Nevertheless, it is necessary to explore the debates regarding trade in goods since they will provide the background for a subsequent analysis of the principle of non-discrimination under the GATS and under International Investment Law.

The first legal element typically used to conceptualise the principle commands a comparison between *the treatments* accorded to the objects at issue (eg, the relevant

69 For some examples of these measures see Nicolas F Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS*, vol 4, International Trade and Economic Law (Cambridge University Press 2010) 38–39.

70 Petros C Mavroidis, 'Come Together? Producer Welfare, Consumer Welfare, and WTO Rules' in Ernst-Ulrich Petersmann (ed), *Reforming the World Trading System: Legitimacy, Efficiency and Democratic Governance* (Oxford University Press 2005) 284.

imported goods against their domestic counterparts). The second element, which is especially important for the purposes of this research, is that of '*likeness*', namely a comparison between *the objects* of the treatment themselves.[71]

Last, but perhaps most importantly there is something 'further' needed to distinguish between measures that have been enacted only to serve a protectionist goal and others which, albeit having a discriminatory effect, serve a legitimate policy goal. In practice, however, it is not inconceivable to come across domestic instruments that are both protectionist and also serve some other legitimacy policy goal. Often, the pursuit of a non-protectionist objective (eg, the protection of health, the environment, prudential regulation, labour rights etc) produces a protectionist or a trade-restrictive effect. The fact that a measure harms trade partners though is *not* sufficient to make it undesirable: often, the benefit to the regulating country may dominate the harm to trade partners.[72]

These are very hard cases to decide since it is conceptually difficult to come up with objective criteria to determine when a State's legislative measure is 'directly aimed at the protection of the domestic market or at favouring one trading partner over another'.[73] The GATT contains a general exceptions clause in Article XX albeit it contains a 'closed' list of sanctioned objectives. Further, its invocation is rather undesirable given its traditionally stringent interpretation.[74] As a consequence, several other methods have been put forth to deal with this conundrum either as a standalone test or as parts of the 'likeness' or 'less favourable treatment' standards.

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71 See Julia Ya Qin, 'Defining Nondiscrimination under the Law of the World Trade Organization' (2005) 23 Boston University International Law Journal 215, 223.

72 Gene M Grossman, Henrik Horn and Petros C Mavroidis, 'National Treatment' in Horn Henrik and Petros C Mavroidis (eds), *Legal and Economic Principles of World Trade Law* (Cambridge University Press 2013) 300.

73 Gráinne De Búrca, 'Unpacking the Concept of Discrimination in EC and International Trade Law' in Catherine Barnard and Joanne Scott (eds), *The Law of the Single European Market Unpacking the Premises* (Hart Publishing, Oxford 2002) 188.

74 See Gisele Kapterian, 'A Critique of the WTO Jurisprudence on "Necessity"' (2010) 59 International and Comparative Law Quarterly 89, 97; Sanford Gaines, 'The WTO's Reading of the Gatt Article XX Chapeau: A Disguised Restriction on Environmental Measures' (2001) 22 University of Pennsylvania Journal of International Law 739; Donald McRae, 'GATT Article XX and the WTO Appellate Body' in Marco Bronckers and Reinhard Quick (eds), *New Directions of International Economic Law* (Kluwer International, The Hague 2000) 226.

## 2. Less Favourable Treatment and Regulatory Distinctions

### *(i) Defining 'Less Favourable Treatment'*

The element of 'less favourable treatment' constitutes arguably the most elementary component of the principle of non-discrimination but, despite its importance, it has not been defined in detail in any of the WTO agreements.[75]

It has long been established in the GATT/WTO case law that – in the context of NT − the benchmark against which we need to assess whether a certain measure constitutes 'less favourable' treatment is the modification of *conditions of competition* within a certain market.[76] Indeed, the accepted interpretation − later verified by the Appellate Body − requires an examination of 'whether a measure modifies the conditions of competition in the relevant market to the detriment of imported products'.[77]

Somewhat peculiarly, the GATT/WTO provisions contain no guidance on whether this standard is also applicable when dealing with potential violations of the MFN principle. There is some case law on the matter, however, which confirms the relevance of competition as the relevant standard.[78] Therefore, as a preliminary conclusion, it can be said that the standard is uniform for both MFN and NT GATT provisions.

Furthermore, it is worth keeping in mind that, unlike discrimination in other legal disciplines, such as human rights, discrimination in trade law is only concerned with

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[75] See on that regard *US – Section 337 Tariff Act* GATT Panel Report, United States Section 337 of the Tariff Act of 1930, L/6439, adopted 7 November 1989, BISD 36S/345 [5.11] which noted that '[t]he "no less favourable" treatment requirement set out in article III:4 is unqualified'; on the relevance of competition between products in general, see also the more recent *Philippines – Distilled Spirits* Appellate Body Reports, Philippines – Taxes on Distilled Spirits, WT/DS396/AB/R / WT/DS403/AB/R, adopted 20 January 2012 [205] *et seq*.

[76] The first report to adopt this standard was GATT Panel Report, *Italy – Agricultural Machinery* GATT Panel Report, Italian Discrimination Against Imported Agricultural Machinery, L/833, adopted 23 October 1958, BISD 7S/60 in the context of interpreting Article III of the GATT; See also Federico Ortino, 'The Principle of Non-Discrimination and its Exceptions in GATS: Selected Legal Issues' in Alexander Kern and Andenas Mads (eds), *The World Trade Organization and Trade in Services* (Martinus Nijhoff, Leiden 2008) 175.

[77] *Korea – Various Measures on Beef* (n 66) [137]–[138]; interestingly, this standard is only directly referred to in article XVII:3 of the GATS the enactment of which postdates that GATT by a few decades:

> Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.

[78] For GATS Article II see, eg, *Canada – Autos (AB)* (n 42) [174] where the Appellate Body implicitly confirmed this reasoning when it criticised the Panel for not examining the 'structure of competition in the wholesale trade services market for motor vehicles in Canada'.

'less favourable treatment' based on the difference in origin of the products or the services in question.[79] In other words, *origin* is the only prohibited basis for differential treatment. Interestingly, this point was only relatively recently verified by the case law[80] in what seems to be a reversal of the previous case law on the matter which seemed to be applying a mere 'detrimental effects' test.[81]

*(ii) Less Favourable Treatment and Regulatory Distinctions under the GATT*

As we explained earlier, very often certain measures serving legitimate regulatory goals might have a detrimental impact on imported products. The rationale, context and history of the GATT indicate that such measures ought to be permitted under the Treaty. Nonetheless, Article XX only exempts measures that serve a closed-list of predetermined policy goals. In that context, several mechanisms have been suggested in order to 'excuse' measures serving other legitimate objectives from scrutiny under the GATT and this discussion has been a recurring theme in the WTO case law. A first method was the 'aims and effects' test under the 'likeness' leg of the test.[82] Nonetheless, elements of that test – with many nuances – also came to infiltrate the 'less favourable treatment standard'.

(a) 'Asymmetric Impact' Assessment

In an effort to salvage the 'effects' part of the 'aims and effects' test – after it was decidedly rejected − it was suggested that a measure should be found to constitute 'less

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79 Furthermore, in Human Rights, there is also a minimum level of protection for all beneficiaries, something that is absent in trade law.

80 See *Dominican Republic – Import and Sale of Cigarettes* Appellate Body Report, Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes, WT/DS302/AB/R, adopted 19 May 2005, DSR 2005:XV, 7367 [96] which noted that 'the existence of a detrimental effect on a given imported product resulting from a measure does not necessarily imply that this measure accords less favourable treatment to imports if the detrimental effect is explained by factors or circumstances unrelated to the foreign origin of the product'; also verifying this point *EC – Approval and Marketing of Biotech Products* Panel Reports, European Communities – Measures Affecting the Approval and Marketing of Biotech Products, WT/DS291/R, WT/DS292/R, WT/DS293/R, Add1 to Add9, and Corr1, adopted 21 November 2006, DSR 2006:III-VIII, 847 [7.2514]; *Thailand – Cigarettes (Philippines)* Appellate Body Report, Thailand – Customs and Fiscal Measures on Cigarettes from the Philippines, WT/DS371/AB/R, adopted 15 July 2011 [128]; *US – Clove Cigarettes* Panel Report, United States – Measures Affecting the Production and Sale of Clove Cigarettes, WT/DS406/R, adopted 24 April 2012, as modified by Appellate Body Report WT/DS406/AB/R [7.268]; *US – Tuna II (Mexico)* Panel Report, United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products, WT/DS381/R, adopted 13 June 2012, as modified by Appellate Body Report WT/DS381/AB/R [4.253].

81 Grossman, Horn and Mavroidis (n 72) 78.

82 For an analysis of the test see *infra* fns 156−173 and accompanying text.

favourable treatment' only if it imposes 'a greater overall disadvantage on imports than on comparable domestic goods' *as a whole*. Thus, comparison should be made between the group of affected imported products against the comparable group of domestic goods[83] in a test which has been labelled by Ehring as the 'asymmetric impact test'.[84] Under such a test, the finding of protective effect becomes a precondition for a finding of violation.

On the contrary, however, it has been suggested that a more appropriate test would be the so-called 'diagonal test' under which the principle is violated even if very few – or arguably even one – imported products are treated less favourably that any domestic ones.[85] In essence, such a test would require offering to all imported products treatment equivalent to the 'best' treatment accorded to 'like' domestic products or services, a

83 The same issue would most certainly be relevant in ascertaining violations of the MFN principle too. There, the comparison would operate in a different dimension, namely between products from different source countries.

84 See Lothar Ehring, 'De Facto Discrimination in World Trade Law National and Most-Favoured-Nation Treatment-or Equal Treatment?' (2002) 36 Journal of World Trade 921, 924−925 who argued that under this test, discrimination only occurs 'if the burden arising from the measure is heavier for imports than for domestic goods'; for other commentators that have used similar terms such as 'disparate impact view', 'discriminatory effect test', 'aggregate comparison approach' and 'narrow' standard of *de facto* discrimination for an essential same test, see Donald Regan, 'Regulatory Purpose and "Like Products " in Article III: 4 of the GATT (With Additional Remarks on Article III: 2)' (2002) 36 Journal of World Trade 443, 470; Davey and Pauwelyn (n 44) 38–41; Federico Ortino, 'WTO Jurisprudence on De Jure and De Facto Discrimination' in Federico Ortino and Ernst-Ulrich Petersmann (eds), *The WTO Dispute Settlement System, 1995-2003*, vol 2003 (Kluwer Law International, The Hague 1995) 260; see also Joost Pauwelyn, 'The Unbearable Lightness of Likeness' in Marion Panizzon (ed), *GATS and the Regulation of International Trade in Services* (Cambridge University Press 2008) 364.

85 See Ehring (n 84) 924 who very succinctly described the two tests:

> Assume for instance a theoretical model situation where 100 domestic producers/products stand vis-à-vis 100 imported 'like' products from foreign producers. Under the extreme *diagonal* test, a measure would already qualify as *de facto* discriminatory if it treats only one imported product less favourably in comparison to one domestic product, regard- less of how the other 99 domestic and 99 imported products are affected by the measure. In consequence, there could be discrimination even if a large majority of imported products are treated more favourably than a large majority of domestic products, as long as 1 imported product receives less favourable treatment than 1 domestic product. In contrast, the extreme *asymmetric* test requires that at least a majority (i.e. 51) of foreign products are treated less favourably than a majority (i.e. 51) of domestic products. Alternatively, a less stringent application is to say that *de facto* discrimination occurs if more or a higher percentage of imported products are negatively affected compared to domestic products, regard- less of the ratio. For instance, six imported products (=6 per cent) receiving less favourable treatment than three domestic products (=3%) would result in *de facto* discrimination just as 80 imports (=80%) compared to 10 domestic (=10 per cent).

treatment which, according to some, would approximate the so-called principle of non-restriction—as reflected in Article 56 TFEU, which deals with the freedom to provide services under EU law.[86] Some scholars have proceeded even further in suggesting that, at least *de lege ferenda*, the principle of non-discrimination should be substituted by a 'necessity' standard that would render all measures which are more cumbersome than necessary for foreign products or services unlawful.[87]

The issue appears not to be settled in the WTO case law. The panel in *EC –Asbestos* seemed to uphold a version of the diagonal test when it proclaimed that it is sufficient that the ban on asbestos disfavours some imported asbestos products and favours some 'like' domestic non-asbestos products.[88] On appeal, the Appellate Body − in an *obiter dictum* − disagreed with that approach and held that 'a complaining Member must […] establish that the measure accords to the group of 'like' imported products less favourable treatment than it accords to the group of domestic products'[89]. In other instances, however, the Appellate Body seemed to be endorsing, to some extent, a test

86 Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 41.

87 Gaëtan Verhoosel, *National treatment and WTO Dispute Settlement: Adjudicating the Boundaries of Regulatory Autonomy* (Hart Publishing, 2002) 51 *et seq*; Aaditya Mattoo, 'MFN and the GATS' in Thomas Cottier and Petros C Mavroidis (eds), *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law* (Michigan University Press, Ann Arbor 2000) 77–79; Aaditya Mattoo, *Shaping Future GATS Rules for Trade in Services*, vol 2596 (World Bank, Development Research Group, Trade 2001) 15; Aaditya Mattoo, 'National Treatment in the GATS: Corner-stone or Pandora's Box' (2009) 31 Journal of World Trade 107, 131–133; Mireille Cossy, 'Some Thoughts on the Concept of "Likeness" in the GATS' in Marion Panizzon, Nicole Pohl and Pierre Sauvé (eds), *GATS and the Regulation of International Trade in Services* (Cambridge University Press 2008) 349.

88 *EC – Asbestos* Panel Report, European Communities – Measures Affecting Asbestos and Asbestos-Containing Products, WT/DS135/R and Add1, adopted 5 April 2001, as modified by Appellate Body Report WT/DS135/AB/R, DSR 2001:VIII, 3305 [8.155].

89 *EC – Asbestos* Appellate Body Report, European Communities – Measures Affecting Asbestos and Asbestos-Containing Products, WT/DS135/AB/R, adopted 5 April 2001, DSR 2001:VII, 3243 [100].

closer to the 'diagonal' test.[90] More recently, the Appellate Body seems to have adopted language that implicitly endorses an 'asymmetric impact test.[91]

The asymmetric impact test seems to be supported by a majority of commentators who have discussed the issue in great detail.[92] Nonetheless, the application of such a measure necessitates an inquiry into the trade effects of a measure. Such an inquiry, however, has never been endorsed in the case law of the WTO.[93] Indeed, in ascertaining whether a measure has modified the conditions of competition, the Panels have never looked at trade effects.

Arguably, the two tests are not mutually exclusive and can be reconciled with the case law as it stands. A finding of 'asymmetric impact' could constitute *prima facie* evidence of discrimination, without being dispositive of the issue. In that sense, it would be a proxy for the identification of protectionism. Such a conceptualisation of the test could have a meaningful role to play in the context of the GATT. Nonetheless, even such a test would not always excuse measures that serve legitimate regulatory objectives.

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90 See *Japan – Alcoholic Beverages I* GATT Panel Report, Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages, L/6216, adopted 10 November 1987, BISD 34S/83 [5.9]; *Japan – Alcoholic Beverages II* Panel Report, Japan – Taxes on Alcoholic Beverages, WT/DS8/R, WT/DS10/R, WT/DS11/R, adopted 1 November 1996, as modified by Appellate Body Report WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, DSR 1996:I, 125 [6.24], [6.27], [6.33], [6.35]; *Japan – Alcoholic Beverages II (AB)* (n 4) 115, 119-123; *contra* Ehring (n 84) 935–937 who disputed that this formed an application of the diagonal test; see also *Canada – Periodicals* WTO Panel Report, Canada – Certain Measures Concerning Periodicals, WT/DS31/R and Corr1, adopted 30 July 1997, as modified by Appellate Body Report WT/DS31/AB/R, DSR 1997:I, 481 [5.28]–[5.30].

91 *EC – Seal Products* Appellate Body Reports, European Communities – Measures Prohibiting the Importation and Marketing of Seal Products, WT/DS400/AB/R / WT/DS401/AB/R, adopted 18 June 2014 [5.117]:

> [W]e consider that the 'treatment no less favourable' standard under Article III:4 of the GATT 1994 prohibits WTO Members from modifying the conditions of competition in the marketplace to the detriment of the *group of imported products* vis-à-vis *the group of like domestic products* (emphasis added).

92 See Ehring (n 84) 942–946; see also Davey and Pauwelyn (n 44) 38–41; DiMascio and Pauwelyn (n 5) 66; Ortino, 'The Principle of Non-Discrimination and its Exceptions in GATS: Selected Legal Issues' (n 76) 179–185; Pauwelyn (n 84) 364; see also Baetens, 'Nationality Based Discrimination in Public International Law with Specific Focus on Human Rights, Trade and Investment Law' (n 6) 91 who suggests that both tests could be used at the same time and that an 'asymmetric impact' finding 'would not be a determinative factor but it could help tip the scales'; see also Ehring (n 84) 928 who first examined the possibility of using both tests.

93 For the first such case see *US – Superfund* GATT Panel Report, United States – Taxes on Petroleum and Certain Imported Substances, L/6175, adopted 17 June 1987, BISD 34S/136 [5.9.1]; see also *Japan – Alcoholic Beverages II (AB)* (n 4) 16; *US – Tax Treatment for "Foreign Sales Corporations"* WTO Appellate Body, WT/DS108/AB/R, adopted 20 March 2000, DSR 2000:III, 1619 [215].

Arguably, a protective effect could only be an incidental – and yet efficient – outcome of a measure.

(b) Regulatory Purpose

This new trend emerged despite the rejection of the 'aims and effects' doctrine[94] and it seems to support the proposition that the 'subjective' or 'regulatory intent'[95] of a certain measure ought to still be examined, but this time under the element of 'less favourable treatment'[96] and not in the context of determining likeness.

This approach − pioneered by Hudec as part the 'aims and effects' test[97] − has also been strongly advocated by Joost Pauwelyn. The latter suggests that the crux of the matter ought to be whether the specific measure in question 'differentiate[s] between, *de jure* or *de facto*, based on the one and only impermissible criterion, namely: national origin'[98] and that the focus ought to shift away from the determination of similarity and 'likeness' between two products. In a nutshell, the modification of the conditions of competition in the relevant market would not amount to 'less favourable' treatment unless the complaining Party can also prove that the defendant is pursuing a true protectionist objective. In essence, however, the examination of the regulatory purpose

94 See *infra* fns 156−173 and accompanying text.

95 For more on the exact meaning of these terms see Petros C Mavroidis, '"Like Products": Some Thoughts at the Positive and Normative Level' in Thomas Cottier and Petros C Mavroidis (eds), *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law: Past, Present, Future* (University of Michigan Press, Ann Arbor 2000) 125.

96 See Daniel A Farber and Robert E Hudec, 'GATT Legal Restraints on Domestic Environmental Regulations' in Jagdish N Bhagwati and Robert E Hudec (eds), *Fair Trade and Harmonization: Prerequisites for Free Trade?*, vol 2 (MIT Press, Cambridge, MA 1996) 76–77; Joel P Trachtman, 'Lessons for the GATS from Existing WTO Rules on Domestic Regulation' in Aaditya Mattoo and Pierre Sauve (eds), *Domestic Regulation and Service trade Liberalization* (World Bank, Oxford University Press, Washington 2003) 64.

97 See Robert E Hudec, 'GATT/WTO Constraints on National Regulation: Requiem for an "Aim and Effects" Test' (1998) 32 International Lawyer 619.

98 Pauwelyn (n 84) 366; Pauwelyn wrote this short paper as a response to Mireille Cossy, of the WTO Secretariat, who suggested that under a 'new and improved 'aim and effects' test' 'elements related to the regulatory context' of the services and/or the service supplier should be taken into account when ascertaining national treatment under the GATS and that this would inevitably result in the 'introduction of proportionality or necessity test'; see also Cossy (n 87) 41.

of a certain measure would be coming back through in a 'sneaky way', despite the fact that the WTO Appellate Body had rejected it.[99]

Shortly afterwards, elements of such an interpretation started to infiltrate the 'less favourable treatment' test. It has been suggested[100] that the first turning point in accepting an element of regulatory intent within the 'less favourable treatment test' was in the *EC –Asbestos* case where the Appellate Body held that:

> [T]he term 'like products' in Article III:4 in this way, we give that provision a relatively broad product scope – although no broader than the product scope of Article III:2. In so doing, we observe that there is a second element that must be established before a measure can be held to be inconsistent with Article III:4. Thus, even if two products are 'like', that does not mean that a measure is inconsistent with Article III:4. A complaining Member must still establish that the measure accords to the group of 'like' imported products 'less favourable treatment' than it accords to the group of 'like' domestic products. The term 'less favourable treatment' expresses the general principle, in Article III:1, that internal regulations 'should not be applied … so as to afford protection to domestic production'. If there is 'less favourable treatment' of the group of 'like' imported products, there is, conversely, 'protection' of the group of 'like' domestic products. *However, a Member may draw distinctions between products which have been found to be 'like', without, for this reason alone, according to the group of 'like' imported products 'less favourable treatment' than that accorded to the group of 'like' domestic products*.[101]

It has been suggested, however, that the AB only referred to the 'effect' of the measure in question without addressing the issue of 'aim' or 'purpose'.[102] There seems

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99 Won-Mog Choi, 'How More "Likeness" in Addressing Technical Regulations?' Society of International Economic Law (SIEL), 3rd Biennial Global Conference, available at SSRN: http://ssrncom/abstract=2104187 or http://dxdoiorg/102139/ssrn2104187, 24.

100 Robert Howse and Elisabeth Tuerk, 'The WTO Impact on Internal Regulations – A Case Study of the Canada-EC Asbestos Dispute' in Grainne De Burca and Joanne Scott (eds), *WTO: Legal and Constitutional Aspects*, vol 283 (Hart Publishing, Oxford 2001) 299; Robert Howse, 'The Appellate Body Rulings in the Shrimp/Turtle Case: A New Legal Baseline for the Trade and Environment Debate' (2002) 27 Columbia Journal of Environmental Law 491, 515; Amelia Porges and Joel P Trachtman, 'Robert Hudec and Domestic Regulation: The Resurrection of Aim and Effects' (2003) 37 Journal of World Trade 783, 796; Henrik Horn and Joseph HH Weiler, 'EC–Asbestos European Communities – Measures Affecting Asbestos and Asbestos-Containing Products' (2004) 3 World Trade Review 129, 147; Trebilcock, Howse and Eliason (n 36) 103; Andrew Lang, 'The GATS and Regulatory Autonomy: A Case Study of Social Regulation of the Water Industry' (2004) 7 Journal of International Economic Law 801, 831.

101 *EC – Asbestos (AB)* (n 89) [100] (emphasis added).

102 Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 82.

to be some consensus though that some of the following cases have been more explicit in adopting such a test. Indeed, the Appellate Body in *Dominican Republic – Import and Sale of Cigarettes* proclaimed that:

> [T]he existence of a detrimental effect on a given imported product resulting from a measure does not necessarily imply that this measure accords less favourable treatment to imports *if the detrimental effect is explained by factors or circumstances unrelated to the foreign origin of the product, such as the market share of the importer in this case* . In this specific case, the mere demonstration that the per-unit cost of the bond requirement for imported cigarettes was higher than for some domestic cigarettes during a particular period is not, in our view, sufficient to establish 'less favourable treatment' under Article III:4 of the GATT 1994.'[103]

Perhaps the Panel in *EC – Approval and Marketing of Biotech Products* is much more akin to a true consideration of regulatory purpose in determining 'less favourable treatment':

> Argentina is not alleging that the treatment of products has differed depending on their origin. In these circumstances, it is not self-evident that the alleged less favourable treatment of imported biotech product*s is explained by the foreign origin of these products rather than, for instance, a perceived difference between biotech products and non-biotech products in terms of their safety, etc*. In our view, Argentina has not adduced argument and evidence sufficient to raise a presumption that the alleged less favourable treatment is explained by the foreign origin of the relevant biotech products.[104]

These instances indicated a certain trend at best, or confusion at worst, but were almost universally interpreted by experts as suggesting that a non-protectionist purpose for a certain measure may be evidence that there is no less favourable treatment.[105] If, however, we examine the context of the statements more closely, it emerges that the 'factors other than origin' refer rather to economic factors of market share than regulatory intent.[106] Indeed, as was later clarified in *US – Clove Cigarettes*,[107] the AB in

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103 *Dominican Republic – Cigarettes (AB)* (n 80) [96] (emphasis added).

104 *EC – Approval and Marketing of Biotech Products* (n 80) [7.2514] (emphasis added).

105 DiMascio and Pauwelyn (n 5) 64–65; Michael Ming Du, 'The Rise of National Regulatory Autonomy in the GATT/WTO Regime' (2011) 14 Journal of International Economic Law 639, 659–64; Weihan Zhou, 'The Role of Regulatory Purpose under Article III:2 and 4—Towards Consistency between Negotiating History and WTO Jurisprudence' (2012) 11 World Trade Review 106–12.

106 Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 82.

*Dominican Republic – Cigarettes* meant to establish a 'causation test' under which a panel ought to consider whether any alleged disparate impact is caused by a challenged measure.[108]

More recently, the issue was finally put to rest in the landmark *EC – Seal Products* case. There, the EU suggested that a finding that a measure has a detrimental impact on the competitive opportunities of imported products ought not to be dispositive; rather, the panel ought to conduct an additional inquiry into whether the said impact stems exclusively from a legitimate regulatory distinction.[109] In essence, it requested the transposition of the NT legal standard under Article 2.1 of the TBT Agreement.[110] The AB, however, decidedly rejected such an approach and, in general, shut the door on any consideration of 'regulatory purpose' under the 'less favourable treatment' leg of the test;[111] a finding of a detrimental impact will automatically send the measure to be justified under Article XX.[112]

#### *(iii) Less Favourable Treatment and Regulatory Distinctions under the TBT Agreement*

The creation of the WTO brought with it the incorporation of the TBT Agreement into the WTO's 'single-undertaking'.[113] The TBT Agreement applies to 'technical regulations', 'standards', and 'conformity assessment procedures' and deviates from the

107 *US – Clove Cigarettes* Appellate Body Report, United States – Measures Affecting the Production and Sale of Clove Cigarettes, WT/DS406/AB/R, adopted 24 April 2012, fn 372; see also *Thailand – Cigarettes (AB)* (n 80) [139]–[140].

108 Weihan Zhou, 'US—Clove Cigarettes and US—Tuna II (Mexico): Implications for the Role of Regulatory Purpose under Article III:4 of the GATT' (2012) 15 Journal of International Economic Law 1110, 1115.

109 *EC – Seal Products (AB)* (n 91) [5.100]; an approach already suggested by Meredith A Crowley and Robert Howse, 'Tuna–Dolphin II: A Legal and Economic Analysis of the Appellate Body Report' (2014) 13 World Trade Review 321, 332; for a first proponent of a similar test see Verhoosel, *National treatment and WTO Dispute Settlement: Adjudicating the Boundaries of Regulatory Autonomy* (n 87) 51–106.

110 See also *infra* fns 174−181 and accompanying text.

111 *EC – Seal Products (AB)* (n 80) [5.117], [5.125].

112 Ming Du, 'Taking Stock: What Do We Know, and Do not Know About the National Treatment Obligation in the GATT/WTO Legal System?' (2015) 1 The Chinese Journal of Global Governance 67, 90; see also William J Davey and Keith E Maskus, 'Thailand–Cigarettes (Philippines): A More Serious Role for the 'Less Favourable Treatment'Standard of Article III: 4' (2013) 12 World Trade Review 163, 178.

113 See Robert Wolfe, 'The WTO Single Undertaking as Negotiating Technique and Constitutive Metaphor' (2009) 12 Journal of International Economic Law 835.

traditional '*negative* integration' [114] logic of the international trade regime. Indeed, Members are obliged to adopt technical regulations and standards that are not more trade restrictive than necessary but also not to discriminate.[115] In that context, it has been suggested 'it could be considerably more intrusive on domestic regulatory choices than the GATT'.[116]

Regarding the principle of non-discrimination, unlike the GATT, the TBT agreement does not contain any exception provision equivalent to the general exceptions clause of Article XX. Therefore, any technical regulation having a detrimental impact on imported products *vis-à-vis* domestic products would violate Article 2.1 of the TBT Agreement—if the same standard as Article III:4 GATT were to be employed.[117] The drafters of the Treaty did not envisage such a deregulatory outcome. The preamble of the TBT agreement stresses the trade liberalisation objective[118] but also emphasises WTO Members' 'right to regulate'.[119] Since 2011, this rather awkward drafting came to the

114 On the difference between positive and negative integration see Federico Ortino, *Basic Legal Instruments for the Liberalisation of Trade: A Comparative Analysis of EC and WTO law* (Bloomsbury Publishing 2004) 17–25.

115 Members shall ensure that in respect of technical regulations, products imported from the territory of any Member shall be accorded treatment no less favourable than that accorded to like products of national origin and to like products originating in any other country', Article 2.1, Agreement on Technical Barriers to Trade 33 ILM 1153 (1994).

116 Robert Howse and Philip I Levy, 'The TBT Panels: US–Cloves, US–Tuna, US–Cool' (2013) 12 World Trade Review 327, 350; see also Henrik Horn and Joseph HH Weiler, 'European Communities – Trade Description of Sardines: Textualism and its Discontent' in Henrik Horn and Petros C Mavroidis (eds), *The WTO Case Law of 2002* (Cambridge University Press 2005) 252 who have argued that '[c]learly the paradigm shift from local discretion to an internationally determined standard and, even more importantly from a regime of discrimination to one of non-justified obstacles is the most germane factor establishing the object and purpose and the context of the TBT (and SPS)'.

117 Du (n 112) 81.

118 Preamble, TBT Agreement :

> *Desiring* however to ensure that technical regulations and standards, including packaging, marking and labelling requirements, and procedures for assessment of conformity with technical regulations and standards do not create unnecessary obstacles to international trade' (emphasis in the original).

119 Preamble, ibid:

> *Recognizing* that no country should be prevented from taking measures necessary to ensure the quality of its exports, or for the protection of human, animal or plant life or health, of the environment, or for the prevention of deceptive practices, at the levels it considers appropriate, subject to the requirement that they are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where

forefront of the WTO DS system. Indeed, the AB in *US – Clove Cigarettes* acknowledged for the first time – citing the aforementioned sixth recital – that a WTO Member has the right to pursue legitimate regulatory objectives.[120]

When it comes to the 'less favourable treatment' leg of the principle, the WTO case law struggled with whether mere detrimental impact is sufficient for a finding of 'less favourable treatment' – as per GATT− or whether this impact must be caused by an impermissible regulatory distinction. The relevant panels and the AB sided with the latter view when they pronounced that mere detrimental impact on the group of imported products was not conclusive for finding 'less favourable treatment'; the detrimental impact must also emanate from a regulatory distinction which cannot be justified.[121] The introduction of this additional element of 'legitimate regulatory distinction' under article 2.1 TBT was attributed to the lack of a general exception clause − like article XX GATT − in the TBT Agreement.[122] Further, it was stressed out that an inquiry into 'the design, architecture, revealing structure, operation, and application' of the measure is necessary for determining whether the measure in question is discriminatory or not.[123] Evidently, such language resembles the chapeau of Article XX GATT[124] but also the sixth recital of

> the same conditions prevail or a disguised restriction on international trade, and are otherwise in accordance with the provisions of this Agreement (emphasis in the original).

120 *US – Clove Cigarettes (AB)* (n 107) [95].

121 ibid [180]–[182], [215]; *US – Tuna II (Mexico)* Appellate Body Report, United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products, WT/DS381/AB/R, adopted 13 June 2012 [215]; *EC – Seal Products* Panel Reports, European Communities – Measures Prohibiting the Importation and Marketing of Seal Products, WT/DS400/R and Add1 / WT/DS401/R and Add1, adopted 18 June 2014, as modified by Appellate Body Reports WT/DS400/AB/R / WT/DS401/AB/R [7.585].

122 *EC – Seal Products (Panel)* (n 121) [7.585].

123 See also *US – COOL* Appellate Body Reports, United States – Certain Country of Origin Labelling (COOL) Requirements, WT/DS384/AB/R / WT/DS386/AB/R, adopted 23 July 2012 [271]; *US – Clove Cigarettes (AB)* (n 107) [224]; *US – Clove Cigarettes (Panel)* (n 80) [182]; *US – Tuna II (AB)* (n 121) [231]–[232]. Perhaps unsurprisingly, the explicit rejection of the relevancy of regulatory intent in *Japan – Alcoholic Beverages* was ignored.

124 See Johannes Norpoth, 'Mysteries of the TBT Agreement Resolved? Lessons to Learn for Climate Policies and Developing Country Exporters from Recent TBT Disputes' (2013) 47 Journal of World Trade 575, 594.

the TBT Agreement. The relationship between the chapeau of article XX GATT and article 2.1 TBT is not immediately clear the panels are still struggling with defining it.[125]

The conclusion we can draw from these developments is that, under the TBT Agreement, the regulatory purpose of a measure is to be taken into account in the determination of 'less favourable treatment'. Arguably, it is impossible to assess the 'design' of a measure without reference to legislative intent.[126]

### 3. 'Likeness' and 'Regulatory Distinctions'

#### *(i) Defining 'Likeness'*

Underlying the principle of non-discrimination is the idea of equality.[127] The conceptual origins of this principle can already be found in Aristotle's 'Nicomachean Ethics' where he defined the principle of equality as treating *like cases alike*.[128] Interestingly, the WTO agreements use very similar language and prescribe that a comparison has to take place between 'like' entities. Indeed, a violation of the principle only occurs if the products are alike in all respects *but* their origin.

The ordinary meaning of the word 'like' in the legal context of discrimination suggests that a 'likeness' test has to establish whether persons, goods, services or projects have the same, similar, resembling or analogous characteristics or qualities.[129]

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125 See *EC – Seal Products (Panel)* (n 121) [7.649]–[7.651] where the panel relied on its analysis under article 2.1 TBT to interpret the chapeau of article XX GATT; see however *EC – Seal Products (AB)* (n 91) [5.310]–[5.313] where the AB reversed the Panel's findings and held that the differences in the legal standard applicable and the main function of article 2.1 TBT and the chapeau of article XX GATT do not permit the application of the same legal test; see also *US – COOL (AB)* (n 123) [271] where the AB had stated that 'arbitrary or unjustified discrimination' under the chapeau of article XX GATT cannot constitute a 'legitimate regulatory distinction' under article 2.1 TBT; see also *US – Tuna II (Mexico) (Article 21.5 – Mexico)* Panel Report, United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products – Recourse to Article 215 of the DSU by Mexico, WT/DS381/RW, Add1 and Corr1, adopted 3 December 2015, as modified by Appellate Body Report WT/DS381/AB/RW[7.558] where the panel left the door open for a consideration of the 'relevant aspects of its reasoning developed in the context of Article 2.1 of the TBT Agreement to its analysis under the chapeau of Article XX of the GATT 1994'.

126 Stephanie Hartmann, 'Comparing the National Treatment Obligations of the GATT and the TBT: Lessons Learned from the EC-Seal Products Dispute' (2014) 40 North Carolina Journal of International Law and Commercial Regulation 629, 667.

127 Qin (n 71) 221.

128 Nicomachean Ethics Aristotle, (Harris Rackham (tr) ed, Harvard University Press, Cambridge MA 1934) 1131a10-b15; *Politics*, III 9, 1280 a8-15, III 12, 1282b18-23, available at www.perseus.tufts.edu/hopper.

129 Baetens, 'Nationality Based Discrimination in Public International Law with Specific Focus on Human Rights, Trade and Investment Law' (n 6) 141.

However, this constitutes partly a tautology since identifying those characteristics as well as their degree of similarity is, in fact, conceptually equivalent. Indeed, the term 'likeness' is far from being 'self-interpreting',[130] something that has been duly noted by the Appellate Body in *EC – Asbestos*:

> First, this dictionary definition of 'like' does not indicate which characteristics or qualities are important in assessing the 'likeness' of products under Article III:4. For instance, most products will have many qualities and characteristics, ranging from physical properties such as composition, size, shape, texture, and possibly taste and smell, to the end-uses and applications of the product. Second, this dictionary definition provides no guidance in determining the degree or extent to which products must share qualities or characteristics in order to be 'like products' under Article III:4. Products may share only very few characteristics or qualities, or they may share many. Thus, in the abstract, the term 'like' can encompass a spectrum of differing degrees of 'likeness' or 'similarity'. Third, this dictionary definition of 'like' does not indicate from whose perspective 'likeness' should be judged. For instance, ultimate consumers may have a view about the 'likeness' of two products that is very different from that of the inventors or producers of those products.[131]

In general, it could be said that the wider the notion of 'likeness' is constructed, the more intrusive the non-discrimination obligation becomes and the intensity of liberalisation is augmented. Indeed, as the Appellate Body has succinctly recognised:

> Some grouping is almost always necessary... since generic categories commonly include products with *some* variation in composition, quality, function and price and, thus, commonly give rise to sub-categories. From a slightly different perspective, we note that 'grouping' of products involves at least a preliminary characterization by the treaty interpreter that certain products are sufficiently similar as to, for instance, composition, quality, function and price, to warrant treating them as a group for convenience in analysis. But, the use of such 'analytical tools' does not relieve a panel of its duty to make an objective assessment of whether the components of a

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130 Mitsuo Matsushita, Thomas J Schoenbaum and Petros C Mavroidis (eds), *The World Trade Organization: Law, Practice and Policy*, vol 127 (2nd edn, Oxford University Press 2006) 209.

131 *EC – Asbestos (AB)* (n 89) [92].

> group of imported products are directly competitive or substitutable with the domestic products.[132]

The crux of the matter concerning the determination of 'likeness' is the identification of the proper *tertium comparationis*, the quality or element two 'situations' or 'objects' have to share for them to be characterised as 'alike' for the purposes of the comparison.[133] In that context, it is necessary to first ascertain the general purpose of the comparison and then, on that basis, devise the relevant criteria of comparison.[134] In the original GATT setting this purpose was mostly the avoidance of concession erosion. However, in a non-tariff world − taking also into account the economic theory underpinning the regime − the most appropriate purpose for this comparison should be the preservation of the opportunity of products to compete within a given market. Indeed, the AB has pronounced that 'likeness […] [is] fundamentally, a determination about the nature and extent of a competitive relationship between and among products'.[135]

Despite the fact that the 'likeness' test is inherent in all non-discrimination provisions under the WTO agreements, there is no uniform standard of 'likeness' across all provisions. This is probably partly the result of textual dissimilarities between provisions and partly of the very contextual nature of the provisions of the WTO Agreement. Indeed, there is a long established GATT 1947 practice − later explicitly endorsed by the Appellate Body −[136] according to which 'likeness' needs to be determined on a case-by-case basis.[137]

The origins of the conceptualisation of notion of 'likeness' can be traced back to the Working Party Report on *Border Tax Adjustments*, adopted by the contracting Parties in 1970, which provided that–

[132] *Korea – Alcoholic Beverages* Appellate Body Report, Korea – Taxes on Alcoholic Beverages, WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999, DSR 1999:I, 3 [142] (emphasis added) (fns omitted).

[133] Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 69.

[134] Qin (n 71) 223–224, 234–235.

[135] *EC – Asbestos (AB)* (n 89) [99].

[136] *Japan – Alcoholic Beverages II (AB)* (n 4) 20.

[137] Border Tax Adjustments: GATT Working Party Report, Border Tax Adjustments, L/3464, adopted 2 December 1970, BISD 18S/97 [18].

> [s]ome criteria were suggested for determining, on a case-by-case basis, whether a product is 'similar': the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality.[138]

Later on, in addition to these criteria, the Panels begun to also take into account the uniform classification in tariff nomenclatures. Eventually, the Appellate Body explicitly endorsed these four criteria providing them with strengthened normative value in *Japan – Alcoholic Beverages II* when it stated that the Border Tax Adjustments Framework constitutes the core element of every 'likeness' analysis.[139]

This does not mean, however, that a uniform standard ever emerged. On the contrary, the way these criteria have been taken into account in the determination of 'likeness' under different non-discrimination provisions of the GATT has varied significantly. If we were to attempt a classification of the different approaches, we can discern two main variants of the standard that − with some nuances − have been employed over the years.

(a) Physical characteristics based 'likeness'

This standard first emerged in the context of interpreting Article III:2, first sentence of the GATT.[140] Under this standard, products not only do they have to share a competitive relationship in the marketplace but, in addition, they need to possess a high degree of similarity of physical characteristics; in that sense, this standard constitutes a subcategory of the broader 'competitiveness' standard that will be analysed later on.[141]

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138 ibid [18].

139 *Japan – Alcoholic Beverages II (AB)* (n 4) 23.

140 Article III:2, second sentence provides that :

> The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

141 *Korea – Alcoholic Beverages (AB)* (n 4) [118]; *Chile – Alcoholic Beverages* WTO Panel Report, Chile – Taxes on Alcoholic Beverages, WT/DS87/R, WT/DS110/R, adopted 12 January 2000, as modified by Appellate Body Report WT/DS87/AB/R, WT/DS110/AB/R, DSR 2000:I, 303 [7.51]; see also Horn and Mavroidis, 'Still Hazy After All These Years: The Interpretation of National Treatment in the GATT/WTO Case-law on Tax Discrimination' (n 49) 45.

Nevertheless, this standard is much narrower and probably echoes earlier GATT jurisprudence,[142] which employed purely formal criteria mostly ignoring or even denying the element of competition.[143] In theory this standard would entail a 'stronger competitive relationship' to exist between two products.[144] The recent *Philippines – Spirits* however seems to have downplayed the importance of tariff classification in constructing likeness even under Article III:2, first sentence:

> [T]he determination of what are "like products" under Article III:2 is not focused exclusively on the physical characteristics of the products, but is concerned with the nature and the extent of the competitive relationship between and among the products.[145]

(b) Broad marketplace based 'likeness'

This standard emerged in the context of Article III:2, second sentence GATT which provides for a slightly different terminology to describe the standard of 'likeness' between products; namely it commands that products are 'directly competitive or substitutable'. This term has been interpreted as demanding the existence of a competitive relationship within the given market place. Somewhat obscurely, the AB attempted to define a variation of this standard for Article III:4 that would require a less intense degree of competitive relationship than the one under Article III:2, second sentence, given the different texts of the two provisions.[146] Such a test would largely be

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142 This earlier standard which sometimes has been characterised as the 'objective standard' of likeness was applied in the context of Article I:1 and III:4 but it is now largely obsolete; see *Germany – Sardines* GATT Panel Report, Treatment by Germany of Imports of Sardines, G/26, adopted 31 October 1952, BISD 1S/53 [13]; *Japan – SPF Dimension Lumber* GATT Panel Report, Canada/Japan – Tariff on Imports of Spruce, Pine, Fir (SPF) Dimension Lumber, L/6470, adopted 19 July 1989, BISD 36S/167 [5.13] *et seq*.; *Australia – Ammonium Sulphate* Working Party Report, The Australian Subsidy on Ammonium Sulphate, GATT/CP4/39, adopted 3 April 1950, BISD II/188 [4.2].

143 For an overview see Mattia Melloni, *The Principle of National Treatment in the GATT: A Survey of the Jurisprudence, Practice and Policy* (Emile Bruylant 2005) 122−125.

144 Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 108.

145 *Philippines – Distilled Spirits (AB)* (n 75) [125].

146 See *EC – Asbestos (AB)* (n 89) [99]:

> For these reasons, we conclude that the scope of 'like' in Article III:4 is broader than the scope of 'like; in Article III:2, first sentence. Nonetheless, we note, once more, that Article III:2 extends not only to 'like products', but also to products which are 'directly competitive or substitutable', and that Article III:4 extends only to 'like products'. In view of this different language, and although we need not rule, and do not rule, on the precise product scope of Article III:4, we do conclude that the product scope of

an absurdity given that it would impose a more rigorous discipline on domestic regulation than to dissimilar taxation[147] and that was probably why it was implicitly remedied later, albeit in a Panel Report, in *Mexico – Taxes on Soft Drinks*.[148]

Furthermore, it is contested whether the same standard would apply for a finding of 'likeness' under Article I:1 on MFN treatment. The case law on the matter suggests that a very strict non-economic interpretation would be applicable[149] but there is no recent case law that could provide guidance. However, we would agree with the view that, at least in relation to internal measures, the same rationale between Article I and Articles III:2, second sentence and III:4 would necessitate the application of the 'broad marketplace' test.[150]

Despite the adoption of a 'marketplace' based test, the use of econometric indicators or any other economic tools of market analysis remained very scarce[151] despite the

> Article III:4, although broader than the *first* sentence of Article III:2, is certainly *not* broader than the *combined* product scope of the *two* sentences of Article III:2 of the GATT 1994.

147 Won-Mog Choi, *'Like Products' in International Trade Law – Towards a Consistent GATT/WTO Jurisprudence* (Oxford University Press 2003) 110; Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 115–116.

148 See *Mexico – Taxes on Soft Drinks* Panel Report, Mexico – Tax Measures on Soft Drinks and Other Beverages, WT/DS308/R, adopted 24 March 2006, as modified by Appellate Body Report WT/DS308/AB/R, DSR 2006:I, 43 [8.106]:

> As regards the likeness of cane sugar and HFCS [under Art. III:4], the factors to be taken into account […] are the *same* as those examined by the Panel when considering whether the two products were 'directly competitive or substitutable' under Article III:2, second sentence.

149 See fns 141−142 and accompanying text.

150 This is implicitly supported by the text of Article I which provides that the provision applies 'with respect to all matters referred to in paragraphs 2 and 4 of Article III'; see also in favour of this view Robert E Hudec, '"Like Product": The Differences in Meaning in GATT Articles I and III' in Thomas Cottier and Petros C Mavroidis (eds), *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law* (Michigan University Press, Ann Arbor 2000) 108–109; Davey and Pauwelyn (n 44) 35; Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 135; see *contra* Qin (n 71) 241 who is cautiously arguing for a 'narrower definition of like products' due to 'differences in policy objectives between the MFN and NT provisions'.

151 For some notable exceptions see *Japan – Alcoholic Beverages II (Panel)* (n 90) [6.22] which decided to employ 'cross-market elasticity' as a relevant criterion and noted that 'the decisive criterion in order to determine whether two products are directly competitive or substitutable is whether they have common end-uses, *inter alia*, as shown by elasticity of substitution'; see also *Japan – Alcoholic Beverages II (AB)* (n 4) 26 and *Canada – Periodicals* Appellate Body Report, Canada – Certain Measures Concerning Periodicals, WT/DS31/AB/R, adopted 30 July 1997, DSR 1997:I, 449, 27 *et seq*. that both later confirmed this analysis.

relevant criticism.[152] Moreover, additional criteria such as marketing studies, price differences, channels of distribution, points of sale, statements by national authorities, evidence from third markets and health risks are occasionally considered without really ever explaining adequately their role in relation to the other criteria.[153] Nevertheless, we can confidently observe that this standard emphasises the 'competitive relationship of two products in a market place' and that it is the standard most frequently employed to clarify the concept of 'likeness' under most non-discrimination provisions.[154]

*(ii) 'Likeness' and 'Regulatory Distinctions' under the GATT*

As we explained earlier, very often certain measures serving legitimate regulatory goals might have a detrimental impact on imported products. The rationale, context and history of the GATT indicate that such measures ought to be permitted under the Treaty.[155] Nonetheless, Article XX only exempts measures that serve a closed-list of predetermined policy goals. In this context, it has been suggested that the competitive relationship between products and services should not be the only element taken into account in the determination of 'likeness'. Rather, it ought to be further considered whether the purpose of regulation is to distinguish the products for legitimate reasons.[156] In other words, 'like products' have to reflect not only a competitive relationship but also 'likeness from a policy point of view.'[157]

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152 Horn and Mavroidis, 'Still Hazy After All These Years: The Interpretation of National Treatment in the GATT/WTO Case-law on Tax Discrimination' (n 49) 61–67.

153 Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 72.

154 This standard, but with the caveats analysed above, largely applies to GATT Articles III:4 (in that respect see *EC – Asbestos (AB)* (n 89) [99] which noted that: 'a determination of "likeness" under Article III:4 is, fundamentally, a determination about the nature and extent of a competitive relationship between and among products') and III:2, second sentence); there is further significant scholarly support for employing this standard for assessing 'likeness' under Article I:1 GATT MFN provision at least with regard to border measures (in that respect see Hudec, '"Like Product": The Differences in Meaning in GATT Articles I and III' (n 150) 108–109; Davey and Pauwelyn (n 44) 35; for a more nuanced view see also Trebilcock, Howse and Eliason (n 36) 71–72.

155 See *supra* fns 96−126 and accompanying text.

156 See Porges and Trachtman (n 100) 785; Won Mog Choi, 'Overcoming the Aim and Effect Theory: Interpretation of the Like Product in GATT Article III' (2002) 8 UC Davis Journal of International Law and Policy 107, 114; see also Grossman, Horn and Mavroidis (n 72) 109−120 who speak of 'market' and 'policy' likeness.

157 Grossman, Horn and Mavroidis (n 72) 307.

Indeed, the first example of introducing a test that takes into account regulatory distinctions within the non-discrimination test is the so-called 'aims and effects' doctrine in GATT jurisprudence. This doctrine was based on a textual interpretation of Article III:1 GATT – acknowledging that III:2 GATT must be understood in light of III:1 GATT – which provides that no internal taxation or regulation measures shall be applied to imported or domestic products '*so as to afford protection to domestic production*'. It requires that the 'likeness' analysis take into account whether a measure 'aims' at the protection of the domestic market and/or has a protectionist 'effect'. The first Report that developed the concept as part of the 'like' products analysis were the *US – Malt Beverages* in 1992 which stated that–

> in determining whether two products subject to different treatment are like products, it is necessary to consider whether such product differentiation is being made 'so as to afford protection to domestic production'. While the analysis of 'like products' in terms of Article III:2 must take into consideration this objective of Article III, the Panel wished to emphasize that such an analysis would be without prejudice to the 'like product' concepts in other provisions of the General Agreement, which might have different objectives and which might therefore also require different interpretations.[158]

The unadopted *US –Taxes on Automobiles* later followed this and further elaborated upon the test:

> Thus the phrase 'so as to afford protection' called for an analysis of elements including the aim of the measure and the resulting effects. A measure could be said to have the aim of affording protection if an analysis of the circumstances in which it was adopted, in particular an analysis of the instruments available to the contracting party to achieve the declared domestic policy goal, demonstrated that a change in competitive opportunities in favour of domestic products was a desired outcome and not merely an incidental consequence of the pursuit of a legitimate policy goal. A measure could be said to have the effect of affording protection to domestic production if it accorded greater competitive opportunities to domestic products than to imported products. The effect of a measure in terms of trade flows was not relevant for the purposes of Article III, since a change in the volume or

[158] *US – Malt Beverages* GATT Panel Report, United States – Measures Affecting Alcoholic and Malt Beverages, DS23/R, adopted 19 June 1992, BISD 39S/206 [5.25].

> proportion of imports could be due to many factors other than government measures.[159]

Nevertheless, even the panels that invoked and applied an 'aims and effects' test did so in name only, at least when it comes to 'effects'.[160] In the name of the premise that Article III GATT is about protecting competitive conditions, the *US – Taxes on Automobiles* held that trade effects are irrelevant.[161]

The theory of 'aims and effects' attracted a lot of attention and was analysed extensively by trade scholars.[162] The main argument against introducing a subjective element to the determination of 'likeness' is that it always requires striking some balance between economic and other policy objectives, something not only difficult,[163] but also inappropriate for WTO panels that do not have the authority to evaluate the legitimacy of different policy purposes.[164] Another problem with this test is that is based on the textual interpretation of a phrase only contained in Article III of the GATT and, as a consequence, it is difficult to see how it would apply to different contexts. Another argument voiced against the 'aims and effects' test is that if WTO panels start assessing policy measures at the stage of 'likeness', this would render Article XX meaningless[165] whilst it would undermine the effectiveness of the principle and contradict the will of the GATT drafters.

These reasons and perhaps also the criticism the test received in literature[166] were probably why the jurisprudence of the WTO was reversed; the Panel Report *US – Taxes*

159 *US – Taxes on Automobiles* GATT Panel Report, United States – Taxes on Automobiles, DS31/R, 11 October 1994, unadopted [5.10].

160 Horn and Mavroidis, 'Still Hazy After All These Years: The Interpretation of National Treatment in the GATT/WTO Case-law on Tax Discrimination' 50; Grossman, Horn and Mavroidis (n 49) 278–283.

161 *US – Taxes on Automobiles* (n 159) [5.10].

162 For an overview see Hudec, 'GATT/WTO Constraints on National Regulation: Requiem for an "Aim and Effects" Test' (n 97).

163 This exercise is particularly difficult since most measures simultaneously serve several different policy objectives. For an explanation see Thomas Cottier, Matthias Oesch and Thomas M Fischer, *International Trade Regulation: Law and Policy in the WTO, the European Union and Switzerland: Cases, Materials and Comments* (Staempfli Publishers 2005) 407.

164 Davey and Pauwelyn (n 44) 38.

165 *Japan – Alcoholic Beverages II (Panel)* (n 90) [6.17].

166 See Davey and Pauwelyn (n 44) who argue for the introduction of a discriminatory-effect test instead; see also Verhoosel, *National treatment and WTO Dispute Settlement: Adjudicating the Boundaries of Regulatory Autonomy* (n 87); see also Lorand Bartels, 'Trade and Human Rights' in Daniel L Bethlehem

*on Automobiles* was never adopted by the GATT Contracting Parties since the EU staunchly opposed the 'aims and effects' test.[167] The first time the issue arose in the WTO era, both the Panel and the Appellate Body in *Japan – Alcoholic Beverages II* flatly rejected the test:

> recalled that the basis of the aim-and-effect test is found in the words 'so as to afford protection' contained in Article III:1. The Panel further recalled that Article III:2, first sentence, contains no reference to those words.[168]

Despite these developments, however, there is still some support for the concept, albeit in a reformulated fashion. Indeed, it has been suggested that the exceptions of Articles XX GATT are not capacious enough to accommodate the appropriate regulatory autonomy of States in the pursuit of internal policies unrelated to trade.[169] In that context, identifying a protectionist measure would require assessing its intent. Additionally, trade effects – despite having been deemed to be irrelevant by the case law − could still constitute one of the proxies for determining intent.[170] Furthermore, the argument that such a test would render Article XX meaningless has been refuted since, arguably, there would still be some utility for the general exceptions clauses since they would remain applicable in cases of *de jure* discrimination.[171]

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and others (eds), *The Oxford Handbook of International Trade Law* (Oxford University Press 2009) 571–596 who are both arguing for the introduction of a 'necessity' test instead; see also Horn and Mavroidis, 'Still Hazy After All These Years: The Interpretation of National Treatment in the GATT/WTO Case-law on Tax Discrimination' (n 49) who are against the test but in favour of the relevance of regulatory intent.

167 See Matsushita, Schoenbaum and Mavroidis (n 83) 240.

168 *Japan – Alcoholic Beverages II (Panel)* (n 90) [6.16] (footnotes omitted).

169 See Henrik Horn and Joseph HH Weiler, 'European Communities – Measures Affecting Asbestos and Asbestos-Containing Products' in Henrik Horn and Petros C Mavroidis (eds), *The American Law Institute Reporters' Studies on WTO Case Law* (Cambridge University Press, New York 2007); Horn and Mavroidis, 'Still Hazy After All These Years: The Interpretation of National Treatment in the GATT/WTO Case-law on Tax Discrimination' (n 49) 55; Frieder Roessler, 'Diverging Domestic Policies and Multilateral Trade Integration' in Jagdish N Bhagwati and Robert E Hudec (eds), *Fair Trade and Harmonization: Prerequisites for Free Trade?*, vol 2 (MIT Press, Cambridge, MA 1996) 30; also in favour Hudec, 'GATT/WTO Constraints on National Regulation: Requiem for an "Aim and Effects" Test' (n 97) 626 *et seq*.; Robert Howse and Donald Regan, 'The Product/Process distinction – An Illusory Basis for Disciplining "Unilateralism" in Trade Policy' (2000) 11 European Journal of International Law 249, 260−261; Regan (n 84) 454.

170 Grossman, Horn and Mavroidis (n 72) 332–334.

171 See ibid 121 who explain:

> A first question is whether this list was intended to describe not only the policy objectives that can serve as grounds for an exception from, e.g., Art. III GATT, but also as a *complete description of all permissible grounds for*

Nevertheless, the re-introduction of the 'aims and effects' test in its original form seems rather unlikely. There is still some support, however, for the relevance of regulatory intent or policy likeness in the applicable non-discrimination test in general, and in the applicable test for the determination of 'likeness' in particular.[172] Horn, Grossman and Mavroidis have very succinctly made the case for 'regulatory or policy likeness' arguing that differences in taxation (and by extension regulation) may 'reflect the government's pursuit of some fundamental roles that economic theory defines as grounds for social-welfare-increasing government market interventions' and, as a consequence, they should be lawful.[173] Nonetheless, the case law as it stands has refused to consider regulatory considerations as a relevant criterion for determining 'likeness'.

*(iii) 'Likeness' and 'Regulatory Distinctions' under the TBT*

In earlier TBT cases the WTO Dispute Settlement System avoided identifying the precise legal text for likeness under article 2.1 TBT exercising judicial economy.[174] Eventually, however, the panel in *US – Clove Cigarettes* pronounced that the determination of likeness should not be approached 'primarily from a competition perspective',[175] and a consideration of regulatory objective(s) was decisive:

> the weighing of the evidence relating to the likeness criteria should be influenced by the fact that Section 907(a)(1)(A) is a technical regulation having the immediate purpose of regulating cigarettes with a characterizing flavour for public health reasons. As explained above, we must pay special notice

> *imposing heavier financial burdens on imported products than on competing domestic products*, as would be maintained according to Interpretation XX. In our view, it does not seem plausible that Art. XX GATT was drafted with this role in mind. It rather appears as if it was meant to serve as a safety valve, as an assurance that despite efforts to ensure that core regulatory values would not be infringed upon, nothing in the agreement would do so.

See also Howse and Regan (n 169); Horn and Mavroidis, 'Still Hazy After All These Years: The Interpretation of National Treatment in the GATT/WTO Case-law on Tax Discrimination' (n 49) 266; Pauwelyn (n 84) 367–368; Regan (n 84) 454–455.

172 Horn and Weiler, 'European Communities – Measures Affecting Asbestos and Asbestos-Containing Products' (n 100) 19–23.

173 Grossman, Horn and Mavroidis (n 72) 118 *et seq*.

174 *EC – Trademarks and Geographical Indications (US)* Panel Report, European Communities – Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs, Complaint by the United States, WT/DS174/R, adopted 20 April 2005, DSR 2005:VIII, 3499 [7.463].

175 *US – Clove Cigarettes (Panel)* (n 80) [7.119].

> to the significance of the public health objective of a technical regulation and how certain features of the relevant products, their end-uses as well as the perception consumers have about them, must be evaluated *in light of that objective*.[176]

The AB unequivocally rejected such an approach holding that likeness should be determined on the basis of 'the competitive relationship between and among the products' in question rather than the 'legitimate objectives and purposes of the technical regulation'.[177] For the AB, it would not always be possible to identify all the regulatory objectives of a measure, something that could lead to an arbitrary determination of 'likeness'.[178] Somewhat bizarrely, however, the AB still held in the abstract that:

> To the extent that they are relevant to the examination of certain 'likeness' criteria and are reflected in the products' competitive relationship, regulatory concerns underlying technical regulations may play a role in the determination of likeness.[179]

The precise difference between the 'regulatory objective' of a measure and the 'regulatory concerns' underlying the measure and which affect the competitive relationship between the products concerned remains undefined—if it exists at all.

Nonetheless, the panel in *US – Tuna (Mexico) II* later confirmed this competition-based approach[180] and the parties agreed that foreign and domestic tuna and tuna products were 'like' before the implementation Panel.[181]

### 4. Regulatory Purpose as a Self-standing Element

It has even been suggested that the regulatory purpose of a measure could constitute a separate leg of the non-discrimination test, which would operate independently and

176 ibid [7.116] (emphasis added).

177 *US – Clove Cigarettes (AB)* (n 107) [112].

178 ibid [113].

179 ibid [120].

180 *US – Tuna II (Mexico)* (*Panel*) (n 80) [7.223]:

> Although this statement was made in the context of Article III:4 of the GATT 1994, we find it pertinent also to an interpretation of the term 'like products' in Article 2.1 of the TBT Agreement.

181 *US – Tuna II (Mexico) (Article 21.5 – Mexico)* (n 125) [7.71].

cover both cases of *de jure* and *de facto* discrimination.[182] Such an interpretation could only find textual support under Article III:1 of the GATT which states that measures: 'should not be applied so as to afford protection to domestic production', a phrase which has been interpreted as informative for the totality of Article III[183].

The Appellate Body first came up with a test to interpret the aforementioned phrase in *Japan – Alcoholic Beverages II*, which was in turn based on what the Panel said in *Japan –Alcoholic Beverages I*, when it clarified that the test concerns the protective application of a measure and not its intent.[184] This pronouncement was harshly criticised in the literature as a covert substitution of the 'aims and effects' test which had already been rejected at that stage.[185]

If we are to assume that this test indeed constitutes an 'objective' third element of the test, it is now largely superseded by the case law rejecting the relevance of trade affects. If, on the other hand, we are to interpret this as a 'subjective' third leg of the test, then its operation within the WTO universe becomes highly problematic; there exists no plausible explanation why such a highly contextual test (one based exclusively on the text of Article III) would only apply to Article III while there is absolutely no textual or other basis to extend the test to similar provisions such as Articles II and XVII GATS.[186]

Therefore, even though there is merit in the proposition that regulatory intent should be taken into account when determining whether a certain measure is discriminatory,

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182 See Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 83; Aaditya Mattoo and Arvind Subramanian, 'Regulatory Autonomy and Multilateral Disciplines: The Dilemma and a Possible Resolution' (1998) 1 Journal of International Economic Law 303, 315–316; Choi (n 147) 122.

183 *EC – Asbestos (AB)* (n 89) [98], [100]; see also *Japan – Alcoholic Beverages II (AB)* (n 4) 17.

184 See *Japan – Alcoholic Beverages II (AB)* (n 4) 28:

> It is irrelevant that protectionism was not an intended objective if the particular tax measure in question is nevertheless, to echo Article III:1, 'applied to imported or domestic products so as to afford protection to domestic production'. This is an issue of how the measure in question is applied.

See also *Chile – Alcoholic Beverages* Appellate Body Report, Chile – Taxes on Alcoholic Beverages, WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000, DSR 2000:I, 281, [61], [71]; *Korea – Alcoholic Beverages (AB)* (n 4) [149].

185 Horn and Mavroidis, 'Still Hazy After All These Years: The Interpretation of National Treatment in the GATT/WTO Case-law on Tax Discrimination' (n 49) 48–49; Hudec, 'GATT/WTO Constraints on National Regulation: Requiem for an "Aim and Effects" Test' (n 97) 633–634; Regan (n 84) 443.

186 Pauwelyn (n 84) 363.

basing it on Article III and then extending it by analogy to other provisions is probably not the best approach.

### 5. Summary

There are three main conclusions we can draw from the application of the principle of non-discrimination under the GATT. First of all, we can observe the increasing role of the marketplace perception in determining whether two products are 'like'. Furthermore, there seems to be some role for 'regulatory purpose' considerations under some of the legs of the non-discrimination test. At the same time, there is also strong opposition for the introduction of such an element, which has led to a highly inconsistent case law on the matter.

The current state of the law seems to be that 'regulatory considerations' are highly relevant in the determination of 'less favourable treatment' under the TBT agreement – but not under the GATT − and could also be potentially relevant in the determination of the competitive relationship between two products under both the GATT and the TBT. Last but not least, despite the adoption of a nominal 'asymmetric impact test', trade effects seem to be irrelevant to a finding of 'less favourable treatment. Overall, however, the recent WTO case law has shown that the AB has fine-tuned its previous jurisprudence and as a result, WTO Members enjoy a broader scope of national regulatory autonomy than conventionally assumed.[187]

## E. NON-DISCRIMINATION AND REGULATORY DISTINCTIONS UNDER INTERNATIONAL INVESTMENT LAW

### 1. Introduction

As we explained earlier, several BITs and FTAs provide for national treatment in respect to the pre-establishment stage of an investment. It was, thus, argued that the 'screening mechanisms' that have the competence to block incoming investments would violate the relevant provisions. In that context, we have suggested that SWF investments should be admitted by host States and be regulated *after* their entry into the relevant market.

[187] Du (n 112) 641.

Nonetheless, all BITs provide for non-discriminatory treatment at the post-establishment stage of an investment as well. Unlike 'screening mechanisms', however, post-establishment regulation of investors would not automatically violate the relevant Treaties. This is due to the fact that investors would have the opportunity to comply with the relevant legislation and still conduct their business. In that context, it is important to examine how investment tribunals have interpreted the principle of non-discrimination so far. The overarching purpose is to assess the precise level of deference permitted under these instruments and, as a consequence, the extent to which host States can draw regulatory distinctions between SWFs and other investors post-establishment.

The analysis of how the International Investment Regime deals with this issue is also important for another reason. As it will be argued, the approach of investment tribunals can constitute a source of inspiration on how to deal with similar issues that arise under the GATS. Arguably, the case law of International Investment Law − a highly decentralised and fragmented regime[188] − has provided a larger array of responses to these issues but, very often, surprisingly convincing.[189] Such an approach goes against the 'tide', which usually attempts to transpose WTO case law on non-discrimination to investment arbitration.[190] Nonetheless, and as explained earlier, the high degree of functional similarity and normative overlap permits such conceptual exercises both ways. Indeed, as observed by Sacerdoti:

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188 There is no *stare decisis* in international arbitration but precedents enjoy a high persuasive value and are constantly cited in subsequent Awards and Decisions; for more on this issue see Frank Spoorenberg and Jorge E Viñuales, 'Conflicting Decisions in International Arbitration' (2009) 8 The Law & Practice of International Courts and Tribunals 91, 102–103; Giorgio Sacerdoti, 'Precedent in the Settlement of International Economic Disputes: the WTO and Investment Arbitration Models' in Arthur W Rovine (ed), *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers* vol 4 (Martinus Nijhoff, Leiden 2010) 225–246.

189 For a very interesting description of how the International Investment Regime manages to eventually produce consistent results despite its highly fragmented nature see Joost Pauwelyn, 'At the Edge of Chaos? Foreign Investment Law as A Complex Adaptive System, How It Emerged And How It Can Be Reformed (January 24, 2014)' available at SSRN: http://ssrncom/abstract=2271869 or http://dxdoiorg/102139/ssrn2271869 .

190 For a tribunal that has considered the WTO case law on non-discrimination as relevant to investment arbitration see *Corn Products International Inc v United Mexican States* (ICSID Case No ARB(AF)/04/1) Decision on Responsibility, 15 January 2008 [122]; for tribunals that have judged the WTO case law as in principle transposable to investment arbitration see *Cargill Incorporated v United Mexican States* (ICSID Case No ARB(AF)/05/2) Award, 18 September 2009 [193]; *Bayindir Insaat Turizm Ticaret Ve Sanayi AS v Islamic Republic of Pakistan* (ICSID Case No ARB/03/29) Award, 27 August 2009 [389]; *International Thunderbird Gaming Corporation v The United Mexican States* (NAFTA/UNCITRAL) Award, 26 January 2006 [174]-[176]; *Methanex Corporation v United States of America* (UNCITRAL/NAFTA) Award, 3 August 2005 [35], [37].

> [I]nternational regulation in both areas is inspired by the same approach in favor of liberalization and *nondiscrimination between domestic and foreign actors of cross-border business activity*, while preserving the competence of importing or host States to regulate the economy and safeguard paramount general interest.[191]

### 2. Less Favourable Treatment and 'Regulatory Distinctions'

#### *(i) 'Diagonal' Impact Assessment*

In general, the majority of arbitral tribunals seem to be employing a 'diagonal' test under which less favourable treatment accorded to one investor can lead to a finding of a breach even when there is only one national receiving better treatment.[192] Occasionally, the application of an 'asymmetric impact' seems to have been considered[193] but there has never been a binding application of such a standard, arguably due to the intricacies of this regime as opposed to the GATT/WTO.

The main rationale behind the application of this more intrusive test is the existence of some fundamental contextual differences between the two regimes of International Economic Law. Firstly, an investor by placing himself under the jurisdiction of the host State of the investment is assuming a more significant risk than a mere trader who can always reorient its business in a different market. It is not just regulation but also administrative practices and other more subtle market obstacles that could hamper or even destroy his investment. A good illustration of this problem can be found in the *GAMI* award. There, the issue concerned Mexico's choice to expropriate certain sugar mills while leaving other mills in private ownership. The claimant argued that the election to expropriate had been driven by nationality concerns. Regrettably, the tribunals failed to realise that discrimination indeed existed at the level of administrative implementation and accepted Mexico's general assertion that the expropriation programme was based on considerations of 'the public interest'.[194] On the contrary, this

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191 Giorgio Sacerdoti, 'Trade and Investment Law: Institutional Differences and Substantive Similarities' (2014) 9 Jerusalem Review of Legal Studies 1, 10 (emphasis added).

192 Baetens, 'Nationality Based Discrimination in Public International Law with Specific Focus on Human Rights, Trade and Investment Law' (n 6) 100.

193 See *Methanex Corporation v United States of America* (n 190) where the tribunal assessed whether the fact that a US measure outlawed a type of fuel which was predominantly produced by foreign investors (methanol) as opposed to another type of fuel (ethanol) where domestic producers had a much larger market share ought to be relevant in the determination of 'less favourable treatment'.

194 *GAMI Investments Inc v Mexico* (UNCITRAL) Final Award, 15 November 2004 [114].

reality was recognised by the award in jurisdiction in *Bayindir v Pakistan* where it was stated that:

> The mere fact that Bayindir had always been subject to exactly the same legal and regulatory framework as everybody else in Pakistan does not necessarily mean that it was actually treated in the same way as local (or third countries) investors.[195]

Furthermore, the treaties (irrespective of the direct vs derivative rights debate) name every individual investor as the beneficiary of the treatment promised under the BIT. This textual difference ought to have some normative consequences for the construction of the non-discrimination principle and, it is submitted, that the application of a 'diagonal' test is very well suited to accommodate these differences.

*(ii) Regulatory Purpose*

Another interesting, albeit isolated, development on the issue that also echoes similar developments under the GATT/WTO system, is the consideration of regulatory intent in interpreting the 'less favourable treatment' prong of the test non-discrimination test. Very interestingly, the tribunal in *Bayindir v Pakistan*, despite proclaiming that the national treatment under the relevant BIT should be interpreted independently from any 'trade law considerations'[196], went on to state that−

> [i]f the requirement of a similar situation is met [i.e. 'likeness' test], the Tribunal must further inquire whether Bayindir was granted less favourable treatment than other investors. This raises the question whether the test is subjective or objective, i.e. whether an intent to discriminate is required or whether a showing of discrimination of an investor who happens to be a foreigner is sufficient. The Tribunal considers that the second solution is the correct one.[197]

A similar approach seems to have been followed by the tribunal in *ADM v* Mexico, which implicitly recognised that both 'intent' and 'effect' are relevant when determining whether a certain measure constitutes 'less favourable treatment':

> In establishing whether the Tax affords "less favorable treatment" to the Claimants, previous Tribunals have relied on the measure's adverse effects on the relevant investors and their

[195] *Bayindir Insaat Turizm Ticaret Ve Sanayi AS v Islamic Republic of Pakistan* (ICSID Case No ARB/03/29) Decision on Jurisdiction, 14 November 2005 [206].

[196] ibid [389].

[197] ibid [390].

> investments rather than on the intent of the Respondent State (S.D. Myers, First Partial Award, para. 254). In the present case, *both the intent and effects* of the Tax show the discriminatory nature of the measure.[198]

This seems to indicate that, in the future, it is not beyond the realm of possibility that investment tribunals would take into account considerations of regulatory context under the 'less favourable' treatment leg of the test—in line with the recent TBT case law. Such a development, however, would break with a long tradition of arbitral awards that have incorporated these elements in their analysis of 'likeness' and does not seem very plausible. Further, it would run contrary to the more recent trend in investment law whereby panels refuse to consider WTO jurisprudence in the interpretation and application of a BIT.[199] Therefore, it is appropriate to consider investment law as already having established a jurisprudence that takes regulatory considerations into account under the 'likeness' leg of the test.

### 3. 'Likeness' and 'Regulatory Distinctions'

#### *(i) Defining 'Likeness'*

A first preliminary observation on the issue of 'likeness' under International Investment Law is that there is a uniform 'likeness' test for both violations of National and MFN treatment. This is not unexpected given the fact that most BITs only contain one clause dealing with discrimination in general, covering both issues.

Furthermore, investment agreements generally do not contain a uniform standard for the determination of 'likeness'.[200] On the one hand, there are a considerable number of agreements that do not qualify the standard of comparison between investors at all. These agreements instruct the parties to grant investors of the other party a treatment no less favourable than the one they accord to 'investors of any third State' – or to 'its own investors' without qualifying it to 'like' or 'comparable' investors, or investors in

198 *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc v United Mexican States* (ICSID Case No ARB(AF)/04/5) Award, 21 November 2007 [209] (emphasis added).

199 Rudolf Dolzer and Christoph H Schreuer, *Principles of International Investment Law* (OUP, New York 2008) 204; for a more general discussion see Verhoosel, 'The Use of Investor–State Arbitration under Bilateral Investment Treaties to Seek Relief for Breaches of WTO Law'; see also *Occidental Exploration and Production Co (OEPC) v Republic of Ecuador* (UNCITRAL/LCIA Case No UN3467) [176]; *Methanex Corporation v United States of America* (n 190) [35], [37].

200 For a review and analysis of the different formulations of the standard of comparison see also UNCTAD, *National Treatment* (United Nations, New York, 1999) 28–33.

'similar circumstances.[201] A number of more recent agreements such as the ones usually concluded by the US and Canada (as well as NAFTA) are constructed so as to limit the application of non-discrimination principles to investors 'in like circumstances'[202], 'like situations'[203], or 'comparable situation'[204], a standard that seems to be narrower[205] than the aforementioned one in the sense that it includes some in-built policy exceptions.[206] This qualification, however, does not seem to have any bearing on the construction of the 'likeness' test[207] despite the fact that it was praised by some as a positive

201 See, eg, Article 3, 1998 German Model BIT of 1998, UNCTAD, *International Investment Instruments: A Compendium* (United Nations, New York and Geneva, 2002) 299 which provides that:

> (1) Neither Contracting State shall subject investments in its territory owned or controlled by investors of the other Contracting State to treatment less favourable than it accords to investments of its own investors or to investments of investors of any third State.
>
> (2) Neither Contracting State shall subject investors of the other Contracting State, as regards their activity in connection with investments in its territory, to treatment less favourable than it accords to its own investors or to investors of any third State

202 See, eg, Article 3.1, United States Model Bilateral Investment Treaty; Article 3.2, Canada Model Bilateral Investment Treaty; Articles 1102,1103, NAFTA; Articles 5.1, 6.1, Framework Agreement on the ASEAN Investment Area (2012).

203 See Article II, [1], Treaty between the Government of the United States of America and the Government of the Republic of Honduras concerning the Encouragement and Reciprocal Protection of Investment, with Annex and Protocol (1995).

204 See Article 4.1, Agreement on Reciprocal Promotion and Protection of Investment between the Government of the People's Republic of China and the Government of the Islamic Republic of Iran (2000).

205 *Contra* Baetens, 'Nationality Based Discrimination in Public International Law with Specific Focus on Human Rights, Trade and Investment Law' (n 6) who argues that even in the absence such a phrase, the *ejusdem generis* requirement would allow for different treatment in objectively different situations.

206 This was the exact phrase used by the US representatives during the OECD's failed MAI negotiations:

> In like circumstances' ensures that comparisons are made between investors and investments on the basis of characteristics that are relevant for the purposes of the comparison. The objective is to permit the consideration of all relevant circumstances, including those relating to a foreign investor and its investment, in deciding to which domestic or third country investors and investments they should appropriately be compared.

Article III, MAI Draft Text of 1997, CONFIDENTIAL DAFFE/MAI(97)1/REV2; see also World Bank, *World Bank Guidelines for the Treatment of Foreign Investment* (1992).

207 Newcombe and Paradell (n 13) 160–161.

development that would provide 'guidance' on the application of the principle.[208] Baetens, for instance, has argued that, despite these differences in the terminology, in fact–

> there is no different likeness test for each treaty, neither is there a different test regarding most-favoured nation as opposed to national treatment, nor does the test differ depending on the subject-matter at hand [...]. The addition of the phrase 'in like circumstances' in some treaties has created the illusion that this would add something to the 'likeness' test: however, it is hard to see the difference in comparison to likeness test in non-discrimination provision which do not contain this addition.[209]

Furthermore, a second general comment that can be made, before we proceed to an analysis of the case law on likeness, is that the existence of a broad standard of comparison is inversely correlated to the ability of the host State to draw regulatory distinctions between different investments and investors, irrespective and, oftentimes, despite their legitimacy.[210] It has been argued, however, that even in the absence of a standard of comparison, some common elements between the different subjects are necessary and not any comparison is possible.[211] Conversely, taking into account 'regulatory intent' in the determination of 'likeness' provides more regulatory space to the host State. It is interesting, thus, to examine in more detail, what has been the balance between these two elements.

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208 UNCTAD, *Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking* (United Nations, New York and Geneva, 2007) 36.

209 Baetens, 'Discrimination on the Basis of Nationality: Determining Likeness in Human Rights and Investment Law' (n 10) 308; for another source making a similar point see *Consortium RFCC v Royame du Maroc* (ICSID Case No ARB/00/6) Award, 22th December 2003 [5]:

> Le contenu de cette disposition qui se rencontre systématiquement dans les traités de protection des investissements ne pose pas de problème d'interprétation particulier. La principale difficulté réside dans son application et plus spécifiquement dans la nécessité de déterminer si la situation de l'investisseur étranger était identique à celle de l'investisseur national ou à celle de l'investisseur d'un pays tiers avec lequel l'Etat d'accueil a conclu un traité similaire de protection des investissements, afin de pouvoir affirmer que la différence de traitement appliquée par l'État d'accueil était ou non justifiée. Cette analyse sera faite au moment de l'examen détaillé des réclamations du Consortium.

210 See UNCTAD, *National Treatment* (n 200) 32; Martín Molinuevo, *Protecting Investment in Services* (Kluwers Law International, The Netherlands 2012) 111; similarly, Mattoo, 'MFN and the GATS' (n 87) 55.

211 UNCTAD, *National Treatment* (n 200) 34.

(a) Market elements of the test – the 'same business' or 'same economic sector' test

First of all, what we can discern from a first reading of the overwhelming majority of arbitral awards is that − as opposed to WTO jurisprudence on 'like products − 'a competitive relationship is not the most fundamental ingredient of foreign and domestic investments in like circumstances'.[212]

Nevertheless, several investment tribunals have tried to come up with a formulation that takes into account the competitive relationship between two investors or investments. The main applicable standards for the determination of that relationship are the 'same business' and the 'same economic sector' standard. The exact construction of the test is important since it reflects the intensity of the competitive relationship between the investors—the former requiring a more intense competitive relationship than the latter. As formulated by Dolzer and Schreuer:

> Is it necessary to identify a domestic investor who is in exactly the same business, or is it sufficient to point to an investor who is not in the same line of business but in the same economic sector?'[213]

Of course, defining even these terms remains a challenge and a uniform answer has not been given to the question. In *Occidental v Ecuador*, a very broad definition of 'likeness' was deemed to be preferable by the arbitrators who stated that a discrimination assessment 'cannot be done by addressing exclusively the sector in which that particular activity is undertaken'.[214] Furthermore, some countries have at times explicitly argued in favour of a test that primarily places emphasis on the existence of a competitive relationship.[215]

212 DiMascio and Pauwelyn (n 5) 71; see *Methanex Corporation v United States of America* (n 190) [34]–[37]; *Occidental Exploration and Production Co (OEPC) v Republic of Ecuador* (n 199) [176]; *Pope & Talbot Inc v Canada* (UNCITRAL/NAFTA) Award on the Merits of Phase 2, 10 April 2001 [57].

213 Dolzer and Schreuer (n 199) 179.

214 *Occidental Exploration and Production Co (OEPC) v Republic of Ecuador* (n 199) [173]; see also Zachary Douglas, 'Nothing if Not Critical for Investment Treaty Arbitration: Occidental, Eureko and Methanex' (2006) 22 Arbitration International 27.

215 See *United Parcel Service v Canada* (NAFTA/UNCITRAL) Award, 24 May 2007, Government of Canada rejoinder [48]; *Methanex Corporation v United States of America* (n 190), United States Government Rejoinder [179].

In a similar, but slightly more restrained vein, a considerable number of tribunals adopted a 'same business or economic sector' test.[216] Interestingly, in one of these cases, the tribunal even went as far as suggesting that the existence of a 'likeness' relationship between the products two investors produce constitutes a 'very strong indication' of 'likeness' for the investors as well.[217]

On the contrary, the tribunal in *Feldman v Mexico* gave a diametrically opposed answer when it proclaimed that 'like circumstances' refer not only to the same economic sector but to even exactly to the same business activity.[218] The tribunal in *UPS v Canada* did not refer to the 'same business or economic sector' but embarked on a broader comparison of regulatory differences as accepted in other countries and under international agreements.[219] Nonetheless, these outcomes seem to be outliers in the case law of investment tribunals.

(b) 'Regulatory likeness' as an element of the test

Other arbitral tribunals seem to be placing a heavier focus on the regulatory context in which investors are operating when they are attempting to determine whether there exists a relationship of 'likeness' between them. This is probably due to the fact that tribunals are very aware that the object and purpose of the non-discrimination obligation is to prevent protectionism while respecting the States' regulatory autonomy to design their legal system according to their specific policies.[220] However, the majority of these

216 *Pope & Talbot Inc v Canada* (n 212) [78]; *Champion Trading Company and Ameritrade International, Inc v Arab Republic of Egypt* (ICSID Case No ARB/02/9) Award, 27 October 2006 [130]; *ADM v Mexico* (n 198) 197–201.

217 *Corn Products International Inc v United Mexican States* (n 190) [120]–[123]; see also *Cargill v Mexico (Award)* (n 190) [194] which proclaimed that 'the fact that an investor is producing a good that is 'like' a domestically produced good does not necessarily mean that the investor is in 'like circumstances' with the domestic producer of that good' even though it accepted the relevance of that criterion in the determination of the existence of 'like circumstances'.

218 *Marvin Roy Feldman Karpa v United Mexican States* (ICSID Case No ARB (AF)/99/1) Award, 16 December 2002 [171].

219 *UPS v Canada (Award)* (n 215) [87]–[120]; see however the dissenting opinion of Ronald Cass on the same case who argued that economic competition is the crucial criterion for determining likeness so he advocated a shift of the burden of proof as soon as the claimant showed the existence of a competitive relationship, similar to the traditional approach in WTO jurisprudence.

220 Baetens, 'Discrimination on the Basis of Nationality: Determining Likeness in Human Rights and Investment Law' (n 10) 300.

treaties contain either no or very restricted exception clauses to allow for some flexibility in the exercise of the regulatory autonomy of the host State.

Arguably, the underlying rationale of all non-discrimination obligations across IEL is the elimination of nationality-based discrimination whilst respecting legislation that addresses legitimate regulatory concerns. In trade law, this is achieved – perhaps imperfectly − through the general exceptions clause of Article XX. In international investment law, often in the absence of an exception clause and whilst in the presence of a more intrusive 'diagonal' test, the method employed is that of a broader 'likeness' test that takes into account legitimate policy objectives.[221]

The landmark case on the issue of regulatory 'likeness' in investment law is certainly the *SD Myers v Canada* award that was rendered in the context of NAFTA. In this case, the arbitrators highlighted the fact that, unlike the GATT, investment agreements do not usually contain a list of exceptions and, as a consequence, the context of the agreement becomes the controlling factor in shaping the principle of 'national treatment as a discipline on purposeful protectionism'[222]—perhaps foretelling the same pronouncement under the TBT Agreement:

> [T]he assessment of 'like circumstances' must also take into account circumstances that would justify governmental regulations that treat them differently in order to protect the public interest.[223]

Later on, the tribunal in *Pope & Talbot v Canada* further elaborated on the same test arguably going a step further. The tribunal proclaimed that any regulatory treatment that was less favourable was, in principle, attributable to the claimant's nationality.[224] This presumption then could only be rebutted if the Respondent could prove that the measure in question

221 ibid 100.

222 Jürgen Kurtz, 'The Merits and Limits of Comparativism: National Treatment in International Investment Law and the WTO' in Stepan W Schill (ed), *International Investment Law and Comparative Public Law* (Oxford University Press 2010) 274.

223 *SD Myers Inc v Canada* (UNCITRAL/NAFTA) Partial Award, 13 November 2000 [250]; see also *Alpha Projektholding GmbH v Ukraine* (ICSID Case No ARB/07/16) Award, 8 November 2010 which cited the aforementioned reasoning with applause.

224 Arguably, the tribunal went a step too far in this case and it has been criticised in the literature for shifting the burden of proof from the claimant to the respondent too soon by simply assuming that a 'same business or economic sector' test suffices to establish a presumption of discriminatory treatment; for a discussion on this see DiMascio and Pauwelyn (n 5) 85–86.

> [had] a reasonable nexus to rational government policies that (1) do not distinguish on their face or de facto, between foreign-owned and domestic companies, and (2) do not otherwise unduly undermine the liberalizing objectives of NAFTA.[225]

Interestingly, the tribunal explicitly rejected the interpretation put forward by all NAFTA Member States according to which only measures that discriminate strictly on the basis of a foreign investment's nationality should be prohibited; instead, it opted to examine any difference in treatment and then required the Respondent to show that the measure 'bears a reasonable relationship to rational policies not motivated by preference of domestic over foreign-owned investments'.[226] Such an approach, however, is arguably a step too far since it has a deregulatory effect not envisaged under the relevant non-discrimination provision.

Similarly, the tribunal in *GAMI v Mexico*, in ascertaining whether a programme of nationalisations that seemed to affect different Mexican companies differently was discriminatory, proclaimed that the existence of a connection between the measure at issue and a legitimate policy goal suffices to justify the difference in treatment:

> The Arbitral Tribunal has not been persuaded that GAMI's circumstances were demonstrably so 'like' those of non-expropriated mill owners that it was wrong to treat GAMI differently. Mexico determined that nearly half of the mills in the country should be expropriated in the public interest. The reason was not that they were prosperous and the Government was greedy. To the contrary: Mexico perceived that mills operating in conditions of effective insolvency needed public participation in the interest of the national economy in a broad sense. The Government may have been misguided. That is a matter of policy and politics. The Government may have been clumsy in its analysis of the relevant criteria for the cutoff line between candidates and non-candidates for expropriation. Its understanding of corporate finance may have been deficient. But ineffectiveness is not discrimination. The arbitrators are satisfied that a reason exists for the measure which was not itself discriminatory. That measure was plausibly connected with a legitimate goal of policy (ensuring that the sugar

225 *Pope & Talbot Inc v Canada* (n 212) [78]; for cases endorsing such an approach see *Sempra Energy International v Argentine Republic* (ICSID Case No ARB/02/16) Award, 28 September 2007 [319]; See also *Enron Corporation and Ponderosa Assets, LP v The Argentine Republic* (ICSID Case No ARB/01/3) Award, 22 May 2007 [282]; *Mytilineos Holdings SA v The State Union of Serbia & Montenegro and Republic of Serbia* (UNCITRAL) Award, 23 September 2009 [435] (not public, on file with the author).

226 *Pope & Talbot Inc v Canada* (n 212) [78].

> industry was in the hands of solvent enterprises) and was applied neither in a discriminatory manner nor as a disguised barrier to equal opportunity.[227]

The *Feldman v Mexico* award again makes an interesting point on the matter. In this case, the tribunal held that when a foreign investment receives 'less favourable treatment' than a domestic investment in the same business or economic sector, it could be presumed that the difference is due to nationality.[228] This finding was, however, qualified later on when the tribunal noted that discrimination only concerns 'unreasonable distinctions between foreign and domestic investors'[229] [...] 'in view of the objective of the regulation'.[230] On the facts of the case, the arbitrators held that the distinction of the Mexican regulation between cigarette-resellers and producers who both exported their products was reasonable but, in an interesting twist, there was a finding of breach due to the fact that Mexico failed to prove a 'reasonable nexus' which would explain why rational non-discriminatory government policies resulted in this disadvantageous tax regime to which the claimant was subjected.[231] Therefore, the tribunal not only endorsed a regulatory 'likeness' test but it proceeded even further by requiring that the regulating State proves that the measure in question is proportionate to aim pursed.

In *Occidental v Ecuador*, the measure in question was an Ecuadorian tax that granted certain export companies a VAT refund based on their status as manufacturers.[232] The tribunal, in that context, 'broadened the scope of application [of the NT provision] so as to encompass all domestic exporters, regardless of business or economic sector and regardless of the nature of the actual export product'.[233] This would appear on first sight to concern the 'asymmetric or diagonal impact' test debate. It is submitted, however, that what the tribunal merely did in this case, was to take into

227 *GAMI Investments Inc v Mexico* (n 194) [114].

228 *Feldman v Mexico* (n 218) [181]; see also for a similar reasoning *Champion v Egypt* (n 216) [133].

229 *Feldman v Mexico* (n 218) [170].

230 ibid [170].

231 ibid [184].

232 *Occidental Exploration and Production Co (OEPC) v Republic of Ecuador* (n 199) [168].

233 ibid [173].

account regulatory 'likeness' in addition to any other criteria of economic nature. Therefore, and since the measure in question concerned the taxation of exporters, all of them ought to be treated alike because the distinguishing criterion of the regulation is the fact that a certain product is exported.[234]

Admittedly, investment tribunals have not followed a uniform approach on this issue. In *Methanex v United States* the tribunal seemed to disregard such considerations. The issue at stake was a regulatory ban on gasoline containing methanol, which left domestic production of gasoline containing ethanol unaffected. The tribunal departed from the 'regulatory likeness' test described earlier and proclaimed that for 'less favourable treatment' to be found, a domestic and a foreign investment have to be 'like' in all other respects but for the nationality or ownership[235]. Therefore, it proceeded to conclude that only domestic methanol producers are comparable to the claimant and refused to strike down the measure as discriminatory. Nevertheless, this case seems to be an outlier within the general trend of the case law.

At the other extreme, DiMascio and Pauwelyn have suggested that the absence of a competitive relationship between two investors or investments can be deemed to be irrelevant in the face of a specific measure, citing the following example:[236]

> [I]f one investor is a toy manufacturer, and another a maker of dyes for fabric, but each uses the same potentially harmful chemical in their production processes, one would not necessarily expect them to be treated differently by a chemical regulation simply because they are in different sectors of the economy.[237]

However, such an approach seems to be far-fetched given that the International Investment Regime was not designed to deal with issues that seem to be concerned primarily with public and health policy.

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234 Baetens, 'Discrimination on the Basis of Nationality: Determining Likeness in Human Rights and Investment Law' (n 10) 303.

235 *Methanex Corporation v United States of America* (n 190) 1444–1449.

236 DiMascio and Pauwelyn (n 5) 85–66; see also Rodney Neufeld, 'Trade and Investment' in Daniel Bethlehem and others (eds), *The Oxford Handbook of International Trade Law* (Oxford University Press 2009) 632 who argues that the inclusion of the phrase 'in like circumstances' permits the 'comparison of treatment applied to two companies belonging to the same industry but also of two companies operating in two completely different measures' and offered the example of a foreign paper versus a steel producer which use the same river to cool their machinery but the former is subject to more stringent environmental regulation, thus, violating national treatment.

237 DiMascio and Pauwelyn (n 5) 85–86.

More recently, the tribunal in *Merill & Ring v Canada* seems to have stricken the right balance between these extremes. It stated that, in the context of NAFTA, a proper construction of the term 'in like circumstances' in light of the context of the agreement would need to take into account both trade or competition objectives as well as other matters, thus adopting a 'merged' test for the determination of 'likeness'.

> In the strict context of a trade treaty, such as the GATT or a number of NAFTA Chapters, the Tribunal might be inclined to understand ―in like circumstances‖ as relating to the need to ensure equality of treatment in respect of competitive opportunities and other trade objectives. But, it must also note that NAFTA, and some other free trade agreements, includes matters that go beyond trade so as to provide for broader mechanisms of economic integration and coordination of economic policies. This is the case of NAFTA Chapter Eleven in respect of investments. It would thus be limiting to relate the concept exclusively to trade objectives and it is thus necessary to understand it in a broader sense that will allow for the comparison of other relevant elements, not excluding trade where appropriate. [238]

This recent award seems to be striking a balance between the competitive relationship of two investors and their products within a marketplace as well as regulatory considerations that might be motivating the regulator. This approach, it is submitted, seems to be the most appropriate and it will now be analysed why.

(c) Critical assessment of the 'likeness' test – a nascent 'merged test'?

These formulations and their interpretations by the respective tribunals seem to reveal a common thread; a degree of similarity between *both* regulatory and market conditions seems to be required before the principles of non-discrimination can be engaged.[239]

Indeed, on the one hand, investment tribunals have attempted to come up with some criteria to define the nature and extent of the competitive relationship that has to be present between investors or their investments for a finding of 'likeness'. Conversely, they have been, on the whole, more than willing to consider policy objectives as relevant criteria for the determination of 'likeness' if the measures in question do not conceal

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238 *Merrill & Ring Forestry LP v Government of Canada* (UNCITRAL/ICSID Administrated) Award, 31 March 2010 [88].

239 Molinuevo (n 210) 119.

protectionist aims or undermine investment liberalisation objectives.[240] It has even been suggested that the trend in the case law suggests that national policies to further the domestic public interest 'can under certain circumstances constitute rational ground' for according discriminatory treatment.[241]

It is, however, submitted that in some cases the tribunals have gone too far in considering primarily issues of 'regulatory likeness' under the non-discrimination disciplines. What would be more appropriate is a 'merged' test that would consider, on balance, *both* the economic-competitive relationship of investments/investors and the specific regulatory issues that have arisen in the context of the specific policy measure at stake. The existence of such a 'merged' test, it is submitted, should be taken to indicate that *both* elements of market and policy 'likeness' have to be present for a tribunal to find a violation of the non-discrimination provision—a process that will heavily rely on the facts of the case.[242]

### 4. SWFs and Regulatory Distinctions under International Investment Law

Our analysis of the case law on non-discrimination shows that the tribunals have turned to the object and purpose as well as the context of the International Investment Regime in resolving recurring issues of construction of the principle. Namely, the fact that Investment Agreements explicitly name investors as beneficiaries of the treatment has prompted tribunals to apply a more intrusive 'diagonal' test for the determination of 'less favourable treatment'.

This increase in the level of intrusiveness, however, has been counterbalanced by a 'likeness' test that takes into account not only the competitive relationship of investors in the relevant market, but also the general regulatory context or the regulatory intent of the regulator. In that sense, investment tribunals examine − admittedly to varying degrees – the policy likeness of a certain measure that impacts foreign investors.

240 Baetens, 'Discrimination on the Basis of Nationality: Determining Likeness in Human Rights and Investment Law' (n 10) 303.

241 Dolzer and Schreuer (n 199) 203.

242 See also Kurtz, 'The Merits and Limits of Comparativism: National Treatment in International Investment Law and the WTO' (n 222) 276 who argues that in the context of determining whether a government was implementing a measure in the pursuance of a protectionist purpose '*all* pertinent evidence should be examined as part of an overall inquiry into trying to identify what political forces are ultimately responsible for the measure in question'.

In that context, any domestic regulation that applies to the operation of SWFs *after* their establishment in the relevant host State market will not automatically run afoul of the substantive protections of the applicable BIT. On the contrary, investment tribunals would examine the regulatory context of the measure in question. In that sense, the host States' regulatory space is widened and domestic regulation that addresses legitimate regulatory concerns surrounding SWFs is likely to be tolerated. Therefore, especially in relation to corporate governance, competition or transparency concerns, host States would be able to design regulation that singles out SWFs post-establishment without that constituting discrimination.

## F. NON-DISCRIMINATION AND REGULATORY DISTINCTIONS UNDER THE GATS

### 1. Introduction

As we analysed in the previous chapter, SWFs – as potential market suppliers – would be covered by the scope of the GATS. Further, the GATS contains a market access obligation which – if the relevant State has made commitments – would prevent host States from restricting or blocking SWFs' investments. In that context, our normative suggestion is that host States *should* be able to regulate SWFs differently – to address any regulatory concerns – but only *after* they have been admitted in the relevant market. In that context, it needs to be ascertained whether the principle of non-discrimination under the GATS would permit the drawing of such regulatory distinctions between SWFs and other market suppliers.

A first caveat that needs to be made before we proceed with the relevant analysis is that, as noted earlier, what is of concern for this thesis are situations of *de facto* discrimination. [243] Our analysis would be applicable in situations of *de jure*

[243] There is no real controversy about whether these measures are covered by the scope of the GATS given that according to Article XVII:3 of the GATS, the requirements of 'less favourable treatment' are met even when a member State is accorded *formally identical* treatment—something also verified by the AB in *EC – Bananas III* WTO Appellate Body, WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591 [233]. The wording is in reality a codification of previous GATT/WTO jurisprudence on the matter that has time and time again verified that the prohibition of *de facto* discrimination extends to all obligations of MFN and national treatment of the GATT; for *de facto* discrimination under Article I GATT see ibid [232]; for Article III GATT see *Japan – Alcoholic Beverages I* (n 90) [3.5], [5.9] *et seq*; for Article II GATS see *EC-Bananas III (AB)* (n 243) [233]; for Article XVII GATS see *EC – Bananas III (Ecuador)* WTO Panel Report, European Communities – Regime for the Importation, Sale and Distribution of Bananas, Complaint by Ecuador, WT/DS27/R/ECU, adopted 25 September 1997, as modified by Appellate Body Report WT/DS27/AB/R,DSR 1997:III, 1085 [6.149]; see also See *US – Section 337 (GATT Panel)* (n 75) [5.11]; *Italy – Agricultural Machinery* (n 76) [12]; for a discussion on *de facto* discrimination see Ortino, 'The Principle of Non-Discrimination and its Exceptions in GATS: Selected Legal Issues' (n 76) 175.

discrimination anyway whilst, as we explained, measures directed against SWFs are likely to be predominantly in the former form. This development echoes an overall trend over recent years according to which the focus of States has shifted to measures that do not discriminate directly on the basis of origin.[244]

The second caveat concerns the methodological approach that will be pursued in addressing this issue. The overwhelming majority of scholars analyse the GATS by adopting the relevant GATT jurisprudence as their venture point. While there are benefits to such an approach, it is submitted that a parallel comparative analysis of both the GATT and the Investment Regime is likely to be more helpful in shedding light upon the issue. Indeed, as we analysed earlier, the rationale of the GATS is slightly different than that of the GATT. Given the dense regulatory web that encompasses services and service suppliers and the absence of border measures, the GATS non-discrimination provisions are, in fact, concerned with guaranteeing market access and preventing discrimination—to the extent that commitments have been made. Such a rationale and the coverage of 'establishment trade' under Mode 3 render such comparisons apposite.[245]

The difficulties, nevertheless, remain especially in relation to the role of 'regulatory considerations', in the absence of any textual guidance:

> It is arguably one of the flaws of the GATS that neither Article II nor Article XVII (and, perhaps to a lesser extent, their GATT counterparts) contain a clear textual basis for a consideration of regulatory purpose.[246]

Indeed, given the inapplicability of border measures, domestic regulation is the only policy instrument through which trade policy can be exercised in the field of services. At the same time, there are legitimate reasons for the regulation of services and service suppliers that have nothing to do with trade policy. In that context, it becomes imperative to distinguish between regulation that is used as an instrument of discrimination and regulation that serves legitimate regulatory objectives. And, unlike the GATT, not erring on the side of the regulator can have important unintended consequences. Therefore,

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244 This same pattern can be especially traced in the area of trade in services since, by definition, tariffs and other border measures do not apply to the provision of services and, thus, taxation and especially regulation become the only relevant measures that could come under scrutiny.

245 See *supra* Ch III.

246 Lang (n 100) 827; see also Mattoo, 'National Treatment in the GATS: Corner-stone or Pandora's Box' (n 87) 131–132.

there is a *prima facie* strong argument for an increased regulatory space under the GATS to accommodate the regulatory considerations of its Members.

An attempt to reintroduce the 'aims and effects' test in the context of the GATS was explicitly rejected by the AB in *EC – Bananas (III)*:

> We see no specific authority either in Article II or in Article XVII of the GATS for the proposition that the 'aims and effects' of a measure are in any way relevant in determining whether that measure is inconsistent with those provisions. In the GATT context, the 'aims and effects' theory had its origins in the principle of Article III:1 that internal taxes or charges or other regulations "should not be applied to imported or domestic products so as to afford protection to domestic production". There is no comparable provision in the GATS. Furthermore, in our Report in Japan - Alcoholic Beverages, the Appellate Body rejected the 'aims and effects' theory with respect to Article III:2 of the GATT 1994.[247]

In that context, it will be assessed whether the case law has dealt with this issue appropriately. Ultimately, a conceptualisation of 'likeness' that permits host States to draw regulatory distinctions between SWFs and other foreign and domestic investors/service suppliers will be put forth.

### 2. 'Less Favourable treatment' and 'Regulatory Distinctions'

#### *(i) Introduction*

The GATT 1947 and WTO case law has consistently recognised that the '*modification of the conditions of competition*' is the relevant standard for determining whether a measure constitutes less favourable treatment,[248] something explicitly recognised – at least in relation to NT – in Article XVII:3 GATS. The GATS MFN provision makes no explicit reference to any modification on the 'conditions of competition' or 'protectionism'; the case law on the GATS, however, has confirmed that the relevance of competition as the defining criterion in determining 'less favourable

247 *EC-Bananas III (AB)* (n 243) [241].

248 See, eg, *EC – Bananas III (Panel)* (n 243) [7.302]; see also the more recent *Argentina – Financial Services* Panel Report, Argentina – Measures Relating to Trade in Goods and Services, WT/DS453/R and Add1, circulated to WTO Members 30 September 2015 [appeal in progress] [7.220].

treatment' under the MFN disciplines.[249] In fact, it is now clear that the standard is the same under both Articles II and XVII of the GATS,[250] despite some initial reluctance.[251]

Nonetheless, the debate on whether 'regulatory considerations' can influence whether the 'conditions of competition' have been modified by the implementation of a measure remains open.

*(ii) 'Asymmetric Impact' or 'Diagonal Test' under Mode 3*

As was the case under the GATT, it has been suggested that an 'asymmetric impact' test should be applied in order to determine whether certain treatment reaches the threshold of 'less favourable' treatment. Namely, the argument goes, we should concede that *de facto* discrimination only takes place when a certain measure imposes a greater disadvantage *on the group* of like foreign services or service suppliers against the 'like' group of *all* domestic services or service suppliers—as opposed to a 'diagonal test'.[252] Conversely, the 'diagonal test' has been described as too onerous for the Member State and even as comparable to the principle of non-restriction – a principle found in much more integrated regimes such as the EU.[253]

However, there are strong arguments against such an 'asymmetric impact test'. First of all, as we have explained earlier the 'asymmetric impact' test was suggested by Ehring as a mechanism to salvage the 'effects' leg of the 'aims and effects' test and, in essence, involves an inquiry into the trade effects of a measure. Nonetheless, the case law of the WTO has never looked at actual trade effects.[254] Arguably, the two tests are not mutually exclusive. A finding of 'asymmetric impact' could constitute *prima facie* evidence of discrimination without being dispositive of the issue. In that sense, it would be a proxy for the identification of protectionism. Nevertheless, given the focus of the

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249 See *Canada – Autos (AB)* (n 42) [174] where the Appellate Body criticised the Panel for failing to take note of 'the structure of competition in the wholesale trade services market for motor vehicles in Canada'; see also the recent *Argentina – Financial Services (Panel)* (n 248) [7.493].

250 *Argentina – Financial Services (Panel)* (n 243) [7.493].

251 See *EC-Bananas III (AB)* (n 243) [231].

252 Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 230.

253 Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 41–43.

254 See, eg, *US – Superfund* (n 93) [5.9.1]; *Japan – Alcoholic Beverages II (AB)* (n 4) 16; *US – FSC (AB)* (n 93) [215].

case law on maintaining equal 'competitive opportunities' irrespective of trade effects, the application of such a test ought to be rejected.[255]

Furthermore, the functional and contextual similarities between investment and Mode 3 trade in services – constituting part of the context − would command a similar test. Unlike trade in goods, the GATS extends its disciplines not only to services but also to service suppliers. The fact that under Mode 3 market suppliers would place themselves and their investments under the territorial jurisdiction of the host State requires a more rigorous level of protection, something not necessary for trade in goods. Additionally, as we analysed in the previous chapter, the GATS extends its non-discrimination obligations to even *potential* market suppliers. These suppliers, under Mode 3, are nothing but investors in the field of services that would very often be covered by some BIT. Therefore, that level of protection would be much more similar to the one sought after the International Investment regime and it would be reasonable to adopt an interpretation of 'less favourable' treatment that would bring the two regimes in line.

Last but not least, an 'asymmetric impact' test would prove to be largely unworkable − at least for NT − given the fact the GATS NT obligations are fragmented between 4 different modes of supply, each subject to potentially different commitments.[256] Indeed, this approach could potentially result in a frustration of the commitments undertaken under certain modes and lead to unpredictability. Arguably, the host State could restrict a certain mode of supply despite the fact that it has undertaken full commitments under it. Even if we were to accept, *arguendo*, that this would not modify the conditions of competition in favour of domestic suppliers and services *per se*, it will nevertheless impose an additional significant cost to foreign service suppliers which would most likely affect the conditions of competition, even if only

255 See *Argentina – Financial Services (Panel)* (n 248) [7.89], [7.95] (and accompanying footnotes referring to the same finding in *US – Gabling* and *China – Publications*).

256 In this context, the crucial question that needs to be addressed is whether the Agreement protects the competitive opportunities of foreign service suppliers with respect to each mode separately, or whether foreign service suppliers should be compared as a whole to the group of domestic suppliers irrespective of mode of supply; see Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 230 who has observed that, in the absence of any guidance from the Treaty, it could even be conceivable to define the two groups by a different *tertium comparationis*. This would lead to a pretty absurd situation where 'if the foreign group consists only of suppliers using the mode that is affected by the measure [...], then there will almost always be an asymmetric impact if the domestic comparative group consists of all competing services and suppliers' whilst 'if both foreign and domestic groups are limited to a specific method, then there is basically never an asymmetric impact on the foreign group'.

temporarily.[257] The restriction of a certain mode of supply would have no consequences for domestic suppliers and services given that the conceptual framework on modes only applies to foreign services and suppliers. On the contrary, however, restricting a certain mode of supply could mean that a foreign supplier would, for instance, have to set up a commercial presence or proceed to some form of investment in order to bypass the restriction.[258]

Therefore, it would be more appropriate to adopt a 'diagonal test' that would allow the comparison between treatment accorded to services and service suppliers *across modes* to take place much more easily and prevent the frustration of any commitments undertaken.

*(iii) Regulatory Purpose*

Mirroring earlier debates under the GATT and the TBT Agreement, it is still disputed whether 'regulatory purpose' ought to be taken into account in the determination of 'less favourable treatment'.

Despite the rejection of the 'aims and effects' test, the recent TBT case law resurrected the hopes that 'regulatory intent' would come to infiltrate the 'less favourable treatment' test under the GATS. In the recent *Argentina – Services* the issue was directly raised by Argentina who suggested that the TBT test is also applicable to the interpretation of 'treatment no less favourable' under both Articles II and XVII GATS. Consequently, it suggested that, 'if the detrimental impact on imports stems from

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[257] A possible counterargument could be based on Footnote 10 of Article XVII which provides that–

> [s]pecific commitments assumed under [...] shall not be construed to require any Member to compensate for any inherent competitive disadvantages which result from the foreign character of the relevant services or service suppliers.

Nonetheless, such a reading of this provision does not seem very plausible since any modification of the conditions of competition would take place after the specific commitments have already been undertaken and, as such, were not envisaged as falling within the scope of Footnote 10.

[258] See Brian Copeland and Aaditya Mattoo, 'The Basic Economics of Services Trade' in Aaditya Mattoo, Robert M Stern and Gianni Zanini (eds), *A Handbook of International Trade in Services*, vol 1 (Oxford University Press 2008) 99 who explain that measures in favour of certain modes may affect trade given that the cost of the supply of a service differs significantly across modes and that some Members may have a competitive advantage under different modes of supply.

"legitimate regulatory considerations"',[259] then a measure should not be found to accord 'less favourable treatment'.

In an important pronouncement, the panel noted that the reference of the GATS to market suppliers is indeed important for the purposes of the test:

> In our view, this immediate context afforded by the actual text of Article II:1 of the GATS, in the light of the special features of services and the importance given to suppliers of services, appears to *indicate that the regulatory framework in which service suppliers operate may in certain circumstances be relevant in the context of the GATS* since it has a direct impact on the service through the natural or legal person supplying the service.[260]

Therefore, the panel seemed to be endorsing the view that 'regulatory considerations' constitute a factor to be taken into account in the determination of 'less favourable treatment' as per Article 2.1 TBT. Nevertheless, it also noted that the GATS, contrary to the TBT Agreement, does not lack a general exceptions clause.[261] Therefore, it fell short of admitting that the standard is the same under both Agreements and, in fact, it noted that none of the interpretations developed under the GATT and the TBT can be transposed directly.[262] The exact difference between this new GATS standard and the ones under the GATT and the TBT remains somewhat of a mystery. The panel, however, made very clear that the host State could *in principle* draw regulatory distinctions between market suppliers without violating the standard:

> We realize that the mention of service suppliers might lead the interpreter, in the light of the specific circumstances of each dispute, to take other aspects into account in its interpretation of "treatment no less favourable", for example, the relevant regulatory aspects concerning service suppliers which have an impact on the conditions of competition. Consideration of these regulatory aspects could, depending on the case, mean that *certain regulatory distinctions between service suppliers*

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259 *Argentina – Financial Services (Panel)* (n 248), Argentina's first written submission [225]–[226] (citing *US – Clove Cigarettes (AB)* (n 107) [175].

260 *Argentina – Financial Services (Panel)* (n 248) [7.212]–[7.213] (footnotes omitted) (emphasis added); it also worth noting that the panel cited both the fourth recital (recognising 'the right of Members to regulate') as well as the third recital of the GATS (goal of trade liberalization with 'due respect to national policy objectives') in support of the aforementioned proposition; nevertheless − somewhat cryptically − it counteracted that by also citing the second and fifth recitals, both emphasizing the goal of liberalization.

261 ibid [7.229].

262 ibid [7.231].

> *established by a Member do not necessarily constitute 'treatment… less favourable*' within the meaning of Article II:1 of the GATS.[263]

Nonetheless, it failed to explain whether the 'purpose' of the relevant measure is what determines its *legitimacy* whilst it seemed to imply that these 'regulatory considerations' are not dispositive of the issue.

*(iv) A Critique of the Current Standard*

Admittedly, it has to be acknowledged that the evolution of the case law under the GATS and the endorsement of a 'less favourable treatment' test that takes into account regulatory considerations is a step in the right direction. Nonetheless, the state of the law remains problematic for a number of reasons. First of all, the panels have failed to explain what renders regulatory distinctions legitimate. The Agreement does not contain − or let alone define − this term, thus, enabling the panels to second-guess the Members' policy choices. This is further reinforced by the fact that ascertaining the existence of 'regulatory considerations' does not seem to be dispositive of the issue but merely *a factor* to be taken into account.

This interpretation, in combination with the GATS' wider scope of application,[264] and the fact that a 'diagonal test' ought to be applied in the determination of 'less favourable treatment' suffices to render the GATS disciplines on non-discrimination *prima facie* more intrusive. This is an unattainable position since the overall balance between trade liberalisation and regulatory autonomy that has been negotiated under the WTO aegis has to be maintained.[265]

In the light of all these factors, it becomes imperative to counteract these deep liberalising features with something else. In that context, supplementing the economic

263 ibid [7.232] (emphasis added).

264 Eg, the fact that the GATS covers any measure that could affect trade in services, it deals with every kind of internal regulation whilst, unlike the GATT, it covers market suppliers and even potential market suppliers.

265 See Thomas Cottier, Petros C Mavroidis and Patrick Blatter, 'Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law: An Overview ' in Thomas Cottier and Petros C Mavroidis (eds), *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law: Past, Present, and Future*, vol 2 (University of Michigan Press 2000) (n 265) 4 who argued that: '[t]he WTO is not (and should not be interpreted as) an instrument for deregulation; see also Mavroidis, '"Like Products": Some Thoughts at the Positive and Normative Level' (n 95) 125 stating that: '[the WTO] does not aim at establishing a unified market where all factors of production circulate without any restriction'.

'likeness' test with a notion of 'regulatory' or 'policy' likeness is the best solution.[266] Thus, a construction of 'likeness' under the GATS that is also in line with the investment regime will be put forth. Such a solution would be contextually more appropriate and produce consistent results in the field of investment in services, which is covered by both regimes.

More importantly for the purposes of this thesis, such a solution would allow host States of SWFs' investments to consistently draw regulatory distinctions between SWFs and other private investors and market suppliers without having to resort to protectionist solutions or even block SWFs' investments at the border.

### 3. 'Likeness' and 'Regulatory Distinctions'

#### *(i) Introduction*

The 'like' product determination has been, as evidenced, one of the 'thorniest' issues in WTO jurisprudence.[267] The conceptual difficulties have persisted under the GATS where the issue has not yet been thoroughly analysed by WTO panels or academics.[268] A mere extrapolation of the doctrinal analysis conducted under the GATT would not suffice[269] given the peculiarities of the GATS in comparison to the GATT.[270]

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266 *Contra* Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 256 who suggests that the adoption of an asymmetric impact test is enough to counter-balance a 'likeness' test which only takes into account economic characteristics of the service and the service and service supplier.

267 Matsushita, Schoenbaum and Mavroidis (n 83) 236.

268 For a notable exception see Diebold, 'Standards of Non-Discrimination in International Economic Law' (n 32); for some other academics that have dealt with the issue see Mireille Cossy, *Determining "Likeness" under the GATS: Squaring the Circle?* (Staff Working Paper ERSD-2006-08, World Trade Organization, Economics Research and Statistics Division, 2009); Pauwelyn (n 84).

269 This was also recently recognized by the Panel in *China – Electronic Payment Services* Panel Report, China – Measures Affecting Electronic Payment Services, WT/DS413/R, adopted 31 August 2012 [7.698] where it was stated that:

> In approaching this matter, we do not assume that without further analysis we may simply transpose to trade in services the criteria or analytical framework used to determine "likeness" in the context of the multilateral agreements on trade in goods. We recognize important dissimilarities between the two areas of trade – notably the intangible nature of services, their supply through four different modes, and possible differences in how trade in services is conducted and regulated (emphasis added).

270 For a number of scholars who have recognised the peculiarities of the principle of non-discrimination under the GATS and have attempted to elaborate on them see Aly K Abu-Akeel, 'The MFN as it Applies to Service Trade—New Problems for an Old Concept' (1999) 33 Journal of World Trade 103, 110−114; Davey and Pauwelyn (n 44) 36; Markus Krajewski, *National Regulation and Trade Liberalization in*

Namely, the principle applies not only to 'like services' but also to 'like market suppliers'.[271] Furthermore, services transactions are intangible and, as such, they cannot be compared on the basis of physical characteristics.[272] Moreover, there is no detailed and uniform classification of services transactions and, in fact, the Services Sectoral Classification List is only optional and cannot be used as a basis for determining 'likeness'—unlike the Harmonized System of tariff schedules.[273] Overall, the concept of 'likeness' in services transactions, unlike trade, remains highly elusive.[274] Since the concept of 'likeness' can differ according to the context of each agreement,[275] however, it could be argued that under the GATS a different approach can be sanctioned.

Thus, in this section, a different conceptualisation of 'likeness' will be put forth; one which prioritises regulatory or policy 'likeness'[276] and, thus, permits Member States to draw regulatory distinctions between different market suppliers—including SWFs.

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*Services: The Legal Impact of the General Agreement on Trade in Services (GATS) on National Regulatory Autonomy* (Kluwer Law International 2003) 99–107; Eric H Leroux, 'Eleven Years of GATS Case Law: What Have We Learned?' (2007) 10 Journal of International Economic Law 749, 779–780; Mattoo, 'National Treatment in the GATS: Corner-stone or Pandora's Box' (n 87) 122–133; Mattoo, 'MFN and the GATS' (n 87) 73–80; Werner Zdouc, 'Legal Problems – Arising under the General Agreement on Trade in Services: Comparative Analysis of GATS and GATT' (Universität St. Gallen 2002) 157–171.

271 This has been expressly recognized by *China – Electronic Payment Services (Panel)* (n 269) [7.700]–[7.705]; see also *Argentina – Financial Services (Panel)* (n 248) [7.160] who endorsed this view.

272 Davey and Pauwelyn (n 44) 49, fn 114 stating that:

> It would seem to be difficult to transpose this approach to the GATS. Since most, if not all, features of services and service suppliers are intangible, none of them can really be said to be objectively linked to the service or service supplier itself.

See also Zdouc (n 270) 159; Footer and George (n 24) 851.

273 See Cossy, *Determining "Likeness" under the GATS: Squaring the Circle?* (n 268) 17–18.

274 As has been recognised by the Working Group on GATS Rules. See Note by the Secretariat, Subsidies and Trade in Services, S/WPGR/9 (6 March 1996) [9].

275 See in that regard, *Japan – Alcoholic Beverages II (AB)* (n 4) 21 which pronounced that:

> The concept of 'likeness' is a relative one that evokes the image of an accordion. The accordion of 'likeness' stretches and squeezes in different places as different provisions of the WTO Agreement are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term 'like' is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply.

276 For other scholars supporting a 'likeness' test under the GATS that at least takes into account 'regulatory considerations' see Mattoo, 'National Treatment in the GATS: Corner-stone or Pandora's Box' (n 87) 128

### *(ii) Defining 'Likeness' under Articles XVII and II of the GATS*

#### (a) Market 'likeness'

We will begin our endeavour from the Article XVII of the GATS which contains the relevant NT treatment obligation according to which:

> [E]ach Member shall accord to services and service suppliers of any other Member […] treatment no less favourable than that it accords to its own like services and service suppliers.

On first sight, we can observe that an important difference between the GATT and the GATS is that Article XVII of the GATS only contains one standard of 'likeness' and omits any reference to the concept of 'directly competitive or substitutable products' of the *Ad* of Article III:2 GATT. This renders an automatic transposition of the GATT case law inapposite.

It has been suggested, however, and it is also this author's opinion, that if paragraphs 2 and 3 of Article XVII are read in conjunction, then a standard based on the competitive relationship between services and service suppliers becomes apposite in this context.[277] Indeed, 'likeness' under Article XVII is more akin to the notion of 'directly competitive or substitutable products'. This is due to the fact that 'the conditions of competition can only be unduly modified through discriminatory measures if the services or suppliers to be compared are in a competitive relationship in the first place'.[278]

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*et seq*. who suggests that 'the scope for making such [regulatory] distinctions is arguably greater in the case of services that in the case of goods' and even goes as far as proposing the introduction of a necessity test to complement the economic notion of 'likeness' under Article XVII of the GATS; Trachtman, 'Lessons for the GATS from Existing WTO Rules on Domestic Regulation' (n 96) 62 who seems to also be in favour of a broader role for the Member States to make regulatory distinctions:

> this [economic] test is relatively ignorant of factors that motivate regulation. The economic theory of regulation suggests that regulation is necessary precisely where consumers cannot adequately distinguish relevant goods – where the goods are in close competitive relation

See also Hudec, 'GATT/WTO Constraints on National Regulation: Requiem for an "Aim and Effects" Test' n (162) 641; Cottier, Oesch and Fischer (n 163) 411; Cossy, 'Some Thoughts on the Concept of "Likeness" in the GATS' (n 87) 346–349; Werner Zdouc, 'WTO Dispute Settlement Practice Relating to the General Agreement on Trade in Services' in Federico Ortino and Ernst-Ulrich Petersmann (eds), *WTO Dispute Settlement System: 1995-2003* (Kluwer International, London 2004) 341–342; see also Japan submission in *US – Measures Affecting the Cross-Border Supply of Gambling and Betting Services* WTO Panel, WT/DS285/R, adopted 20 April 2005, as modified by Appellate Body Report WT/DS285/AB/R, DSR 2005:XII, 5797 [4.44f].

277 Mattoo, 'National Treatment in the GATS: Corner-stone or Pandora's Box' (n 87) 110; Friedl Weiss, 'The General Agreement on Trade in Services' (1995) 32 Common Market Law Review 1177, 1211.

278 Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 124.

Furthermore, the narrow concept of 'likeness' under Article III:4 of the GATT is primarily determined on the basis of 'physical characteristics'. An attempt to conduct an analogous exercise for 'like' services and service suppliers would be futile given the intangibility of 'services and the absurdity of comparing service suppliers on the basis of their 'physical characteristics'. Last but not least, the standard of 'less favourable treatment' under Article XVII:3 GATS seems to be less strict than the one in GATT Article III:2 which does not allow even a *de minimis* difference in taxation. These arguments, *prima facie* at least, indicate that the competitive relationship between 'services' and 'service suppliers' should be taken into account when ascertaining 'likeness' in line with the GATT jurisprudence on *Ad* Article III.

Turning now to the GATS MFN provision, Article II of the GATS provides that:

> With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country

Given the absence of any interpretative guidance in the GATS framework, it is useful to undertake a comparative approach with the GATT MFN treatment.[279]

First of all, the minor textual similarities[280] between the two provisions are arguably of no importance given the way the GATT has been interpreted.[281] Furthermore, − and similarly to trade in goods − the general economic rationale of the MFN principle in the field of services is the efficient allocation of resources and its multiplier effect that accelerates the liberalisation of trade.[282] Nonetheless, given the primary importance of tariffs in the GATT, the specific rationale and function of Article I differs according to

279 Such a methodological approach concerning MFN treatment has been confirmed by the Appellate Body in *EC – Bananas III (Panel)* (n 243) [231]; Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 137.

280 Namely, the fact that Article II GATS applies broadly to any measure 'affecting trade in services' without having to resort to a reference to the relevant NT provision whilst it obliges Members to accord no less favourable treatment in general and not to extend any 'favour, advantage, privilege or immunity'.

281 Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 136; see also Zdouc, 'WTO Dispute Settlement Practice Relating to the General Agreement on Trade in Services' (n 276) 382–383; Yi Wang, 'Most-Favoured-Nation Treatment under the General Agreement on Trade in Services—And its Application in Financial Services' (1996) 30 Journal of World Trade 91, 97.

282 Abu-Akeel (n 270) 107; John H Jackson, 'Constructing a Constitution for Trade in Services' (1988) 11 The World Economy 187, 196; see *contra* Horn and Mavroidis, 'Economic and Legal Aspects of the Most-Favored-Nation Clause' (n 38) 270 who argue that there is a plurality of economic rationales and that such simplistic descriptions of one economic rationale simply 'do not seem to hold up'.

the type of measures it concerns. Hudec, most prominently, argued that the scope of 'likeness' under Article I should vary depending on whether the measure in question concerns tariffs or internal taxes and internal regulations.[283] Namely, when it comes to tariff measures, the objective of the WTO ought to be 'the orderly management of protection in order to contain its effects and remove its unnecessary evils'.[284] On the other hand, when dealing with internal measures, the rationale is exactly the same as the one underlying Articles III and I,[285] namely the elimination of market distortions and the protection of competitive opportunities within a given market, as has also been recognised by the Appellate Body with regard to Article III:2, second sentence and Article III:4 GATT.[286] Therefore, the conceptualisation of 'likeness' under paragraphs 2 and 4 of Article III, as has been perceived by the Appellate Body, should apply by analogy to Article I with regard to internal measures.[287]

Turning to the GATS, the absence of tariffs renders the need to balance mutually negotiated tariff concessions redundant.[288] Thus, it is reasonable to assume that the term

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283 Hudec, '"Like Product": The Differences in Meaning in GATT Articles I and III' (n 154) 103; Robert E Hudec, 'Tiger, Tiger in the House: A Critical Appraisal of the Case Against Discriminatory Trade Measures' in Ernst-Ulrich Petersmann and Meinhard Hilf (eds), *The New GATT Round of Multilateral Trade Negotiations: Legal and Economic Problems* (2nd edn, Kluwer Law and Taxation 1991) 175.

284 This explains why the earlier case law on Article I – which mainly concerned tariffs − adopted a more strict interpretation of 'likeness' focusing on physical characteristics rather than a competitive relationship between products; see *Germany – Sardines* (n 142) [12] *et seq*.; *Japan – SPF Dimension Lumber (GATT Panel)* (n 142) [5.13] *et seq*.; for a slightly different approach that seems to take more into account 'marketplace' factors see *Spain – Unroasted Coffee* GATT Panel Report, Spain – Tariff Treatment of Unroasted Coffee, L/5135, adopted 11 June 1981, BISD 28S/102 [4.7]; for the case-law relating to internal rather than border measures applying a similar reasoning see *Australia – Ammonium Sulphate* (n 141) [8]; *EEC – Animal Feed Proteins* GATT Panel Report, EEC – Measures on Animal Feed Proteins, L/4599, adopted 14 March 1978, BISD 25S/49 [4.2].

285 It is for this reason that some authors had suggested that the same criteria which are applied in regard to Article III:2, first sentence are relevant in the determination of 'likeness' under Article I; see Trebilcock, Howse and Eliason (n 36) 65; Hudec, '"Like Product": The Differences in Meaning in GATT Articles I and III' (n 154) 113–119; Matsushita, Schoenbaum and Mavroidis (n 83) 211.

286 It seems that at least in one occasion a Panel has recognised that in principle, a finding of 'likeness' under Article III:4 GATT due to non-contradiction allows for a finding of 'likeness' for purposes of Article I GATT; see *EC – Trademarks and Geographical Indications (US)* (n 174) [7.714].

287 See Davey and Pauwelyn (n 44) 35; See also William Davey, John Jackson and Alan Sykes, *Legal Problems of International Economic Relations* (West Publishing Company 1995), Chapter 10; for scholars sceptical but not completely dismissive of the idea see Qin (n 71) 241; Steve Charnovitz, 'Green Roots, Bad Pruning: GATT Rules and Their Application to Environmental Trade Measures' (1994) 7 Tulane Environmental Law Journal 299, 323.

288 Matsushita, Schoenbaum and Mavroidis (n 83) 620; Rüdiger Wolfrum, 'Article II GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll and Clemens Feinäugle (eds), *WTO: Trade in Services* (Martinus Nijhoff 2008) 83 who suggests recourse to the Border Tax Adjustments Framework as applied in Article III GATT for the interpretation of Article II GATS.

'likeness' should be interpreted broadly and focus on the competitive relationship between two services or service suppliers by analogy to Article I GATT.

The GATS case law seems to have progressively acceded to such a standard. Indeed, in *Canada – Autos*, the Appellate Body stated that:

> The Panel did not identify any evidence defining the relationship between manufacturers and wholesale trade service suppliers of motor vehicles in the Canadian market. Furthermore, the Panel did not examine, *in concreto,* the structure of competition in the wholesale trade services market for motor vehicles in Canada.[289]

More importantly, however, the panel in *China – Electronic Payment Services* concluded that 'like services are services that are in a competitive relationship with each other (or would be if they were allowed to be supplied in a particular market)'.[290]

Such an interpretation would equate the standard of 'likeness' under these two provisions with the standard under Article III:2 GATT as well as Article III:4 GATT and XVII GATS.

Indeed, in the recent *Argentina – Goods and Services*, the panel not only upheld the relevance of a 'competitive relationship' for determining likeness but also explicitly equated the standard under both Articles II and XVII:

> In our view, the likeness analysis under Article II of the GATS does not differ from the 'likeness' analysis under Article XVII of the GATS in the sense that it requires an approach based on the competitive relationship […]. Indeed, not only is the term to be interpreted the same but the context afforded by the term 'treatment no less favourable' also informs the likeness determination in both cases.[291]

(b) The argument for 'regulatory' or 'policy' likeness

A closer look at the context of the two agreements, however, reveals that this is not the end of the matter. Under GATT Article III:2, this broader competitive standard is qualified by the requirement that the discriminatory tax must not be *de minimis* and that it has not been adopted 'so as to afford protection'. In contradistinction, GATS Article

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289 *Canada – Autos (AB)* (n 42) [174].

290 *China – Electronic Payment Services (Panel)* (n 269) [7.700].

291 *Argentina – Financial Services (Panel)* (n 276) [7161]; see also *EC – Bananas III (Panel)* (n 243) [7.346] where the Panel analysed the element of 'likeness' under Article II GATS by direct reference to its previous analysis of 'likeness' under Article XVII GATS.

XVII contains no such distinction between *de minimis* and more substantial discriminatory measures whilst the reference to 'so as to afford protection' is completely absent. Last but not least, as argued, the appropriate test to ascertain 'less favourable treatment' at least under Mode 3 ought to be the 'diagonal' test due to the intrinsic characteristics of 'commercial presence' that is much more akin to investment. This, however, would render a pure 'economic likeness test' extremely onerous for the Member States and inappropriately intrusive to their regulatory autonomy. Therefore, if the same balance between the regulatory autonomy and liberalisation is to be maintained under the GATS, then something further needs to be added.

It has been suggested that the different method of scheduling measures in the GATS and the fact that there is a dual system of positive and negative listing is inherently much more flexible and, thus counterbalances the aforementioned intrusive standard.[292] I would beg to differ with this approach mainly for two reasons. First of all, non-discrimination provisions concern regulatory or tax measures that violate or upset the overall degree of liberalisation that has *already* been negotiated between the Parties; this should not be taken as indicative of a diminished intrusiveness in the regulatory autonomy of the States. Secondly, and perhaps most importantly, the phrase 'so as to afford protection' is indeed hinting that regulatory considerations have to be taken into account in some form or the other.

These normative objections are – to an extent – supported by the negotiating history of the Agreement. In some of the first drafts, even the term 'like' was omitted and the text required the States to offer 'treatment no less favourable than that accorded to domestic services [or service suppliers] *in the same market*'[293] or *under the same conditions*.[294] This would indicate the adoption of a broad economic 'marketplace' wording which would even supersede the notion of 'likeness' and, thus, any issues of 'regulatory likeness' that could flow from it. Later on, in the draft text released in July 1990, the term 'likeness' was introduced to compare services and the term '*in like circumstances*' to compare between service suppliers:

292 Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 126.

293 Report to the Trade Negotiations Committee meeting at Ministerial level, Montreal, December 1988, MTN.GNS/21 (25 November 1988) [11].

294 See ibid which provided in the relevant provision that: 'MFN means that signatories grant all other signatories *[under the same conditions]* any advantage granted to another country unilaterally or as a result of trade negotiations. Non-discrimination means that signatories accord to each other treatment no less favourable than that accorded to any country'.

> In conformity with other relevant provisions of the framework, and as set out in their appropriate schedules, parties shall grant to services and service providers of other parties, in the application of all laws, regulations, administrative practices, and decisions of general application, treatment no less favourable than that accorded to like domestic services or service providers in like circumstances.[295]

This term, however, was in turn substituted by the term 'in like circumstances', a formulation which persisted until the December 1990 draft,[296] only to be replaced by the term 'like services and like service providers' in the final text. This distinction is really interesting since it echoes the provision ultimately adopted in the NAFTA negotiations concerning the 'likeness' of investors while it recognises that a slightly different standard is probably needed when comparing between 'service suppliers' than when we are comparing between 'services'. It has been suggested that the 'like circumstances' standard is probably wider than the 'same market' concept and it allows space for taking into account regulatory considerations.[297] This is a reasonable reading of the situation and also an indication that a consideration of 'regulatory likeness' was also in the minds of the GATS negotiators and not just a judicial construct of Panels later on. Indeed, the US, a party to both these agreements (which not coincidentally were being negotiated during the same time period) still argues that the terms 'like circumstances' and the concept of 'likeness' under the GATS do not differ.[298] A similar view is held by Mexico and Canada, also parties to both these agreements.[299]

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295 Draft – Multilateral Framework for Trade in Services, MTN.GNS/35, 23 July 1990, draft Article XVII on national treatment.

296 See Draft – Multilateral Framework for Trade in Services, MTN.GNS/35, 23 July 1990, draft Article III on MFN treatment which provided that:

> With respect to any measure covered by this framework, each party shall accord to services and service providers of another party, treatment no less favourable than that it accords *in like circumstances* to services and service providers of any other [country] [party].

297 Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 121.

298 See *US – Trucking Services* (NAFTA Arbitral Panel) Final Report in the Matter of Cross-Border Trucking Services, USA-MEX-1998–2008–01, 6 February 2001which stated that:

> The Parties [Mexico and the United States] do not dispute that the use of the phrase 'in like circumstances' [in Article 1202 of the NAFTA] was intended to have a meaning that was similar to the phrase 'like services and service providers', as proposed by Canada and Mexico during NAFTA negotiations.

299 See Molinuevo (n 210) 119.

This standard, however, did not find its way into the final text. We can only conjecture on why this happened but it would not be unreasonable to argue that the negotiators wanted to keep the GATT and the GATS as consistent as possible, at least in terms of language. In conclusion, it seems that the negotiators probably did not want to adopt an exclusively and overtly broad and economic test, otherwise they would have omitted the term 'likeness' altogether as it was first suggested.

The panels and the Appellate Body have not given a definitive answer to these questions yet. In *EC – Bananas III* the panel noted that 'the nature and the characteristics' of the services in question are relevant when determining 'likeness' without further analysing the application of such criteria.[300] In *Canada – Autos*, the panel followed the approach taken in *EC – Bananas III* without further clarifying the standard of likeness for services. In *China – Publications and Audiovisual Products*, however, there was a first hint that factors 'other than origin' could affect the 'likeness'—at least between services suppliers:

> [I]n cases where a difference of treatment is not exclusively linked to the origin of service suppliers, *but to other factors*, a more detailed analysis would probably be required to determine whether service suppliers on either side of the dividing line are, or are not, 'like'.[301]

This pronouncement was also repeated in *China – Electronic Payment Services*[302] and the panel seemed to also verify that such a case-by-case 'separate inquiry' is only applicable in determining the likeness of suppliers—without however further clarifying the nature of the other factors.[303]

In the recent *Argentina – Goods and Services*, the panel proceeded one step further by clarifying the elusive 'other factors' that come into play in the determination of likeness between service suppliers. The panel – citing *EC – Asbestos* – pronounced that 'regulatory concerns and considerations may play a role in determining in applying

300 *EC – Bananas III (Panel)* (n 243) [7.322].

301 *China – Publications and Audiovisual Products* Panel Report, China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products, WT/DS363/R and Corr1, adopted 19 January 2010, as modified by Appellate Body Report WT/DS363/AB/R, DSR 2010:II, 261 [7.975] (emphasis added).

302 ibid [7.697].

303 *China – Electronic Payment Services (Panel)* (n 269) [7.705].

certain of the “likeness criteria” […] and, thus in the determination of “likeness”.[304] In that sense, it accepted in principle that regulatory considerations can be ‘other factors’ to be taken into account in a likeness analysis, ‘provided that this is reflected in the competitive relationship between services and service suppliers’.[305] Nevertheless, the panel failed to address the discrepancy with *EC – Asbestos III* − which said no such thing − whilst neglecting to clarify the relationship between regulatory considerations that affect likeness and the legitimate regulatory objectives of a measure that can be considered under the ‘less favourable treatment’ leg of the test.

This admittedly positive normative development is unsatisfactory. Indeed, not all regulatory considerations will be reflected in the competitive relationship between services and service suppliers and, arguably, the argument for government intervention is even more powerful in the field of services that in relation to goods.

The economic theory, which informs all such agreements, can shed some light on what ought to be the proper interpretation. Services are much more complex in structure and mostly comprise ‘experience goods’[306] and ‘credence goods’[307]—as opposed to goods which fall almost exclusively in the category of ‘search goods’.[308] In the case of the former two categories of ‘goods’ there are serious imbalances of information which sanction a much more interventionist role for governments. These informational problems are further accentuated by the stronger negative externalities between consumers and service suppliers. Indeed, considerations of systemic stability, competition, corporate governance or even income distribution are much more pronounced in the case of services and service suppliers. Thus, regulatory interventions – especially in respect of Mode 3 where service suppliers operate within the host State

304 *Argentina – Financial Services (Panel)* (n 248) [7.178].

305 ibid [7.179].

306 In the case of ‘experience’ goods, the quality becomes obvious ex post. This type of product features high pre-buying costs of quality detection. Hence, the buyer learns the product’s attributes typically only after buying and consuming. See Phillip Nelson, ‘Information and Consumer Behavior’ (1970) 78 Journal of Political Economy 311, 311–29.

307 In the case of ‘credence’ goods, their quality can be ascertained only at some cost after purchase and consumption, and eventually might never be fully open to objective evaluation. Most non-network services such as health services, legal services and financial services fall into this category; see ibid 311–29.

308 In the case of search goods, their quality is known ex ante or it can be ascertained at low cost prior to purchase. Thus, the degree of uncertainty for the consumer, the asymmetry of information and, consequently, the rationale for governmental intervention is low. See ibid 311–29.

market − are much more necessary and justifiable from an economic efficiency point of view than in relation to goods.

Therefore, it is submitted, the 'likeness' standard under the GATS needs to not only be less strict – than in relation to goods – but also to emphasize or even prioritise 'policy likeness' over 'market likeness'. In that context, a finding of 'likeness' under the GATS should require that the relevant services or service suppliers are *both* market-like and policy-like—requiring the presence of both elements and not a 'balancing' process.[309]

*(iii) Determining the 'Likeness' of Services and Service Suppliers*

(a) Introduction

One of the distinguishing characteristics of trade in services is the often inseparable nature of a service from the service supplier. Indeed, this characteristic often – with the exception of Mode 1 services trade − entails a cross-border move not only for the service, as would have been the case with goods, but also of the service supplier. By doing so, however, the supplier is automatically subject to the jurisdiction of the host State and has to comply with its laws and regulations, a fact that could be exploited for discriminatory purposes.[310] Furthermore, services are very often subject to a dense regulatory framework that applies not only to the services but to the suppliers as well. The combination of these factors is the reason why the scope of application of the GATS has been expanded to include measures affecting service suppliers too in its ambit.[311] This development is particularly important for the purposes of this research since host States might have legitimate reasons to regulate the operation of SWFs within their market, and as argued, should be allowed to do so.

However, the correlation between the elements of 'likeness' of services and service suppliers is not very clear and the way the two elements interact could have important consequences for the breadth and extent of the non-discrimination obligation. The relevant question is whether services, service suppliers or both have to be 'alike' for a violation of non-discrimination to be found. Pursuant to the combined economic and policy 'likeness' test we have submitted, the relationship between the two elements will

309 For a similar line of argumentation under the GATT, see Grossman, Horn and Mavroidis (n 72) 312−328.

310 See Krajewski (n 270) 103.

311 Cossy, *Determining "Likeness" under the GATS: Squaring the Circle?* (n 268) 6–7.

determine how and to what extent the host State can draw valid regulatory distinctions between SWFs and other foreign and domestic market suppliers.

(b) Individual or contingent determination of 'likeness'

Some scholars have suggested that the distinction between services and service suppliers is, in fact, a *non sequitur* since 'any treatment of services is also, in effect, a treatment of the suppliers thereof and vice versa'.[312] The relevant case law only seems to be enhancing the controversy surrounding the matter. Indeed, the Panel in *EC – Bananas III*, when examining the complainant's claim that the EC regime discriminates against distributors of Latin American bananas in favour of distributors of EC and traditional ACP bananas, stated that−

> it seems that each of the different service activities taken individually is virtually the same and can only be distinguished by referring to the origin of the bananas in respect of which the service activity is being performed. Similarly, in our view, *to the extent that entities provide these like services, they are like service suppliers*.[313]

The Panel seemed to suggest that all entities providing 'like' services are 'like' service suppliers and, in fact, this section of the Report remained unchallenged by the Parties. The Panel in *Canada – Autos*, held the same view, at least 'for the purposes of this case'.[314] Such a reading renders the notion of 'like' service suppliers entirely contingent upon a finding of 'likeness' between services. Perhaps not a great emphasis should be placed upon these *dicta* since the measures under scrutiny did not discriminate on the basis of supplier, but on the basis of service-related characteristics.[315]

312 However, see Abu-Akeel (n 270) 109–110 who claims that this distinction has no practical significance at least with regard to MFN treatment under the GATS: 'So, while it is hard to imagine a situation where the distinction in the GATS' MFN clause between services and service suppliers or between measures affecting services and measures affecting service suppliers would have particular significance or a distinct scope of applicability in the context of the MFN clause, there does not seem to be any harm in the distinction; except for the confusion it may cause as it implies that the distinction has a practical significance'.

313 *EC – Bananas III (Panel)* (n 243) [7.322].

314 *Canada – Certain Measures Affecting the Automotive Industry* WTO Panel, WT/DS139/R, WT/DS142/R, adopted 19 June 2000 [10.247].

315 Davey and Pauwelyn (n 44) 36; Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 196.

Indeed, more recently, the previous jurisprudence seems to have been reconsidered. The Panel in *China – Publications and Audiovisual products* stated that '[s]ince the United States focuses its claim on the treatment of suppliers rather than services, we will likewise centre our analysis on the likeness of the suppliers of the services at issue'.[316] Furthermore, in more detail, the Panel seems to suggest that the determination of likeness' for service suppliers is given an autonomous meaning, independent of the similar determination about the 'likeness' of services and one which is to be determined on a 'case-by-case' basis:

> Turning now to the issue of 'likeness' of service suppliers, we note that in a different dispute, a panel has found that entities may be considered like service suppliers if, and to the extent that, they provide like services. [footnote omitted] We agree that the fact that service suppliers provide like services may in some cases raise a presumption that they are 'like' service suppliers. However, we consider that, in the specific circumstances of other cases, a separate inquiry into the 'likeness' of the suppliers may be called for. For this reason, we consider that 'like service suppliers' determinations should be made on a case-by-case basis.[317]

The case under scrutiny though was differentiating on the basis of origin, thus constituting *de jure* discrimination and, as a consequence, the Panel did not proceed to an extensive substantive analysis of 'likeness'. The panel in *Argentina – Goods and Services* verified the aforementioned reasoning but also failed to perform an extensive analysis, since the relevant measure was also based on origin.[318]

The current interpretation of the Panels seems not to be in accordance with the negotiating history of the GATS. In fact, it seems to be more in line with an early December 1990 draft of the GATS that provided for a disjunctive and not a cumulative formulation:

> Most-Favoured-Nation Treatment
>
> 'With respect to any measure covered by this Agreement, each Party shall accord immediately and unconditionally to services and service providers of any other Party, treatment no less favourable than that it accords to *like services and providers of*

[316] *China – Publications and Audiovisual Products (Panel)* (n 301) [7.1283].

[317] *China – Electronic Payment Services (Panel)* (n 269) [7.705].

[318] *Argentina – Financial Services (Panel)* (n 248) [7.171]–[7.184].

> *like services* of any other country [in like circumstances] [with respect to the same mode of delivery].'
>
> National Treatment
>
> '1. In conformity with other relevant provisions of this Agreement, and in accordance with the conditions and qualifications set out in its schedule, each Party shall accord to services and service providers of other Parties, in respect of all measures affecting the supply of services, treatment no less favourable than that accorded to *like domestic services or providers of like services*'.[319]

Indeed, the approach adopted by the Panels – in line with that initial draft − presents some further difficulties. A first issue is that such an approach, which does not allow the Member States to make regulatory distinctions between two different 'suppliers', is overly restrictive.[320] A good example offered by Diebold is the provision of loans by banks and department stores that issue credit cards to their customers.[321] In these situations, the regulator usually imposes different regulatory requirements exactly because of the different nature of these institutions and such regulatory interventions ought to be sanctioned. Furthermore, even if two service suppliers are much more 'similar' than the aforementioned example, there are several legitimate reasons why a regulator would want to treat them differently. For instance, legal or medical services are subject to qualification and licensing requirements,[322] many professional titles are

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319 Trade Negotiations Committee, Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations MTN.TNC/W/35−3/Rev.1 (3 December 1990), draft Articles II and XVII (emphasis added).

320 Krajewski (n 270) 104; Verhoosel, *National treatment and WTO Dispute Settlement: Adjudicating the Boundaries of Regulatory Autonomy* (n 87) 61 who very vividly explains:

> [s]aying that the likeness of service suppliers is wholly dependent on, and determined by, the likeness of their services, would go far beyond non-discrimination and impose absurd levels of deregulation on members. The latter would be effectively impeded from making regulatory distinctions between service suppliers offering like services.

See also Zdouc, 'Legal Problems – Arising under the General Agreement on Trade in Services: Comparative Analysis of GATS and GATT' (n 270) 163–164; Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 198.

321 Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 197.

322 See Michael J Chapman and Paul J Tauber, 'Liberalizing International Trade in Legal Services: A Proposal for an Annex on Legal Services Under the General Agreement on Trade in Services' (1994) 16 Michigan Journal of International Law 941, 970 who note that:

subject to rules of conduct and ethics[323] while other supplier characteristics such as the legal form, size or the financial state of the company may necessitate differential regulation.[324]

A further argument in favour of such an interpretation is that the GATS explicitly names 'foreign suppliers' as its beneficiaries, a fact from which certain consequences ought to flow. Indeed, and at least under Modes 3 and 4 the GATS, foreign suppliers have to become subject to the laws and regulations of the importing State. In that context, however, it is only reasonable that the Member States can differentiate between suppliers they perceive as 'unlike' without having to resort to the general exceptions of Article XIV GATS.[325] This would be an *e contrario* argument from the GATT, where the current consensus is that Member States are not in a position to differentiate between competing products on the basis of producer characteristics since the GATT's scope of application does not cover producers.[326]

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> Because substantial differences in education, training, and experience requirements exist between lawyers of different countries, Members might argue that domestic and foreign lawyers do not provide 'like services' and should not be considered 'like service suppliers.

See also Verhoosel, *National treatment and WTO Dispute Settlement: Adjudicating the Boundaries of Regulatory Autonomy* (n 87) 62; Krajewski (n 270) 105 who states that: '[i]t could be argued that a nurse who received university education is not like a nurse who received 'only' vocational training'.

323 See George Nnona, 'Multidisciplinary Practice Under the World Trade Organization's Services Regime' (2005) 16 Indiana International & Comparative Law Review 73 who states that:

> [t]he issue arises whether legal services provided by domestic U.S. lawyers practicing independently of other professionals in the context of stricter ethical rules and constraints of the legal profession are alike to legal services offered by professionals (be they U.S. or foreign) working collaboratively in the MDP context under manifestly different ethical rules and cultures.

324 See Peter Van den Bossche, The Law and Policy of the World Trade Organization: Text, Cases and Materials (Cambridge University Press 2008) who states that:

> [T]wo service suppliers that supply a like service are not necessarily 'like service suppliers'. Factors such as the size of the companies, their assets, their use of technology and the nature and extent of their expertise must all be taken into account.

325 Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 202.

326 See *US – Restrictions on Imports of Tuna* GATT Panel Report, DS21/R, DS21/R, 3 September 1991, unadopted, BISD 39S/155 [5.14], [5.18] which stated that PPMs fall outside the scope of Article III if they do not affect the product as such; see also *US – Gasoline* Panel Report, United States – Standards for Reformulated and Conventional Gasoline, WT/DS2/R, adopted 20 May 1996, as modified by Appellate Body Report WT/DS2/AB/R, DSR 1996:I, 29 [6.11]; *US – Import Prohibition of Certain Shrimp and Shrimp Products* WTO Panel Report, WT/DS58/R and Corr1, adopted 6 November 1998, as modified by Appellate Body Report WT/DS58/AB/R, DSR 1998:VII, 2821 [7.11] *et seq.*; see also Steve Charnovitz,

It thus becomes apparent that the current line of interpretation is rather unpersuasive too. A separate determination of 'likeness' of service suppliers, it is submitted, is the most appropriate interpretation in that context.[327]

(c) Regulatory 'likeness' of service suppliers

Given that there should be an independent determination of the 'likeness' of service suppliers and that this determination should, according to our submission, account for the 'policy' likeness of the market suppliers, the question that arises is whether the type and nature of ownership of market suppliers is an element that should be taken into account. Namely, can the fact that a service supplier is owned or controlled by a SWF render two service suppliers 'unlike' for the purposes of the GATS and, thus, allow the Member State to regulate them differently?

Interestingly, there seems to be some support for the proposition that the type of ownership of a service supplier should be a relevant characteristic for the determination of 'likeness' in GATS[328] even though no disputes involving SWFs have arisen in the GATS context. In *US – Gambling*, the US argued that:

> Antigua also ignores potentially relevant differences in service suppliers. For example, Antigua states that US state lotteries are supplied exclusively through state monopolies, but nowhere does it attempt to say what, if anything, makes its (presumably private, non-state) service suppliers 'like' state lottery monopolies in any sense. Nor does it try to explain how its suppliers are 'like' the associations that control pari-mutuel

'The Law of Environmental "PPMs" in the WTO: Debunking the Myth of Illegality' (2002) 27 Yale Journal of international Law 59, 86 *et seq*.; Robert Read, 'Like Products, Health & Environmental Exceptions: The Interpretation of PPMs in Recent WTO Trade Dispute Cases' (2004) 5 Estey Centre Journal of International Law and Trade Policy 123, 128–133.

327 For scholars arguing along the same lines see Verhoosel, *National treatment and WTO Dispute Settlement: Adjudicating the Boundaries of Regulatory Autonomy* (n 87) 34, 61; Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 204; Kalypso Nicolaïdis and Joel P Trachtman, 'From Policed Regulation to Managed Recognition in GATS' in Pierre Sauvé and Robert M Stern (eds), *GATS 2000 – New Directions in Services Trade Liberalization* (Bookings Institution Press, Washington D.C 2000) 254; Davey and Pauwelyn (n 44) 36; Mattoo, 'National Treatment in the GATS: Corner-stone or Pandora's Box' (n 87) 133.

328 This proposition seems to run contrary to an established principle of WTO law and, more generally, of international law that of the ownership neutrality of rules; see Julia Ya Qin, 'WTO Regulation of Subsidies to State-owned Enterprises (SOEs) – A Critical Appraisal of the China Accession Protocol' (2004) 7 Journal of International Economic Law 863.

> wagering services on horseracing in the United States, or any other special type of supplier in the US market.[329]

This argument indicates that a State-owned or State-created monopoly supplier should be considered 'unlike' for the purposes of GATS non-discrimination obligation. The US, however, did not explain whether ownership would somehow impact a competition-based consumer perspective and indeed, this seems to be rather unlikely at least in this context[330]. The argument, however, could be taken as evidence of support for considering the regulatory intent when ascertaining 'likeness' between service suppliers. Indeed, later on in the pleadings, the US adopted such a position when it stated that:

> Regulatory distinctions are directly relevant under GATS Article XVII, and should be considered in their own right − not solely through the lens of consumer perceptions [...]. Thus one must consider not only the different competitive characteristics of a service or supplier as such, but also the existence of regulatory distinctions between services in interpreting and applying the likeness analysis under Article XVII [...]. As previously discussed, the United States maintains and applies a regulatory distinction between remotely supplied gambling services and other gambling services, with the former subject to even tighter restrictions than the latter. This distinction arises from the numerous distinguishing law enforcement, consumer protection, and health concerns associated with the remote supply of gambling.[331]

Alternatively, the US also attempted to insert the element of regulatory intent at the stage of examining whether the treatment offered is indeed 'less favourable':

> According to the United States, even if it were to be assumed that likeness could be established between some remotely supplied gambling and betting services and service suppliers and non-remote gambling and betting service and service suppliers, the United States may, nonetheless, maintain a regulatory distinction between remote and non-remote supply of such services given that such a distinction does not afford

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329 *US – Gambling (Panel)* (n 276) [3.154].

330 Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 255; for a different view, however, see Juan A Marchetti and Petros C Mavroidis, 'What Are the Main Challenges for the GATS Framework? Don't Talk About Revolution' (2004) European Business Organization Law Review 511, 534 who argue that in instances like this where there is a state monopoly, it is conceivable that the relevant state service supplier would not be competing in the same relevant market despite the fact that they are offering 'like' services.

331 *US – Gambling (Panel)* (n 276) [3.188].

> less favourable treatment to foreign suppliers on the basis of national origin.[332]

Therefore, in line with our previous analysis, we submit that Member States should be able to draw regulatory distinctions between different service suppliers and an interpretation that is prohibitive of that should not be sanctioned.[333] Under such an approach, host States should have the ability to regulate SWFs operating within their market and the GATS should be more accommodating of their legitimate regulatory concerns.

(d) The interplay between 'likeness' for services and service suppliers

Given the fact that the GATS non-discrimination obligation extends to both services and service suppliers, it is very important to examine the relationship between these two elements and their interplay in the context of determining whether a measure has breached the obligation. Many different interpretations have been put forth in the literature and their application could widen or restrict the scope of the obligation quite considerably.

A possible interpretation of the relationship between the 'likeness' of services and service suppliers is to consider the connecting term 'and' as cumulative, which would indicate that for a measure to be discriminatory, it should treat less favourably 'like services' and 'like service suppliers' *simultaneously*.[334]

Nevertheless, there is scholarly support for the proposition that usually[335] a measure that treats a service less favourably would, at the same time, constitute less favourable treatment for the service supplier.[336] In that context, what becomes crucial is the

332 ibid [6.423].

333 See Cossy, *Determining "Likeness" under the GATS: Squaring the Circle?* (n 268) 20 who is arguing that taking into account such supplier-related characteristics might make sense under a test that takes into account regulatory intent but she is, nevertheless, sceptical on differentiating between market suppliers on the basis of the type of ownership (public or private).

334 See also Markus Krajewski and Maika Engelke, 'Commentary to Article XVII GATS (national treatment)' in Rüdiger Wolfrum, Peter-Tobias Stoll and Clemens Feinäugle (eds), *WTO – Trade in Services*, vol 6 (Martinus Nijhoff, Leiden and Boston 2008) 408–409.

335 We can however envisage some exceptions to this proposition: if a market supplier supplies two different services within a given market and the market concentration is different for these two distinct services, a measure that only affects the supply of one service should not automatically constitute less favourable treatment for the market supplier.

336 Abu-Akeel (n 270) 109; Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 205.

determination of 'likeness', which, for this test, would have to be present for both the service and the service supplier. Understandably, the standard of proof is very high under this test since the scope of the provision would be limited to only measures that affect both.

This interpretation is highly problematic and it should be dismissed. The rationale for extending the principle of non-discrimination to measures affecting service suppliers in the GATS was to not allow Member States to restrict trade in services and circumvent their commitments through regulation directed at the supplier rather than the service—given that under Modes 3 and 4, the suppliers would be under the jurisdiction of the host State.[337]

A second interpretation suggests that the relevant provisions contain two separate and alternative obligations to offer less favourable treatment to *either* services *or* service suppliers.[338] The element of 'less favourable treatment', like in the cumulative test, would be fulfilled since the treatment of one inevitably affects the other. Therefore, a Member State would be found to be in violation of the non-discrimination principle if a measure affects merely services that are 'like' irrespective of the 'likeness' between the 'service suppliers'.[339] In that sense, the provisions contain two obligations and, as a consequence, restrict the regulatory space of the Member States more than the cumulative test.

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337 See Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 205 who also cites as evidence the GATS scheduling guidelines which provide that 'the national treatment obligation in Article XVII does not require a Member to extend such treatment to a service *supplier* located in the territory of another Member', Guidelines for the Scheduling of Specific Commitments Under the General Agreement on Trade in Services (GATS), S/L/92 (28 March 2001) [15].

338 This approach coincides with the one offered under NAFTA Chapter 11.

339 See, in that respect, Antigua's argument in *US – Gambling (Panel)* (n 276) C-44: '[t]hus Article XVII mandates treatment 'no less favourable' for "like services" and "like service suppliers", without limiting that obligation to situations in which both the services and the services suppliers are "like". For a very illustrative example of the two situations see Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 208 who explains:

> Assume a foreign insurance company would like to supply the same services in country A as the local bank A. If country A treats the foreign service less favourably than the 'like' domestic service, the alternative test allows the adjudicating bodies, in principle, to find a violation of the GATS national treatment obligation purely on the basis that the services are 'like' and that the imported service is treated less favourably. In contrast, to the extent the foreign insurance company and the domestic bank are not considered as 'like', the measure adopted by country A would not be in breach with GATS national treatment if a cumulative test is applied.

It can be suggested that this would an unusual interpretation given that the ordinary meaning of the term is conjunctive and not disjunctive. Interestingly, the negotiators actually considered in one of the early drafts to include the term 'or' instead of 'and'.[340] Diebold argues that this should not be taken as evidence that this interpretation was indeed examined and rejected by the Parties and that both the readings are plausible. Indeed, he argues, a possible explanation of the change of heart could be that the inclusion of the term 'or' would have allowed the Parties to claim that they can treat foreign suppliers less favourably as long as long as services itself are treated equally and *vice versa*.[341] This would have allowed the Parties to escape all scrutiny since all they would have to do is to translate all domestic regulations into a form that targets only the service or the service supplier.

The alternative test, thus, seems to be more plausible and more fitting into the overall context of the Agreement. Some further difficulties, however, remain. The main issue is whether the Panels would both examine whether there is less favourable treatment *either* to 'like' services *or* to 'like' service suppliers in a method which has been coined the 'combined' approach. It could also be argued, however, that the WTO adjudicating bodies ought to limit the scrutiny to either the service or service supplier; if the panels first examine whether there is favourable treatment between services, there is no option to examine at the situation of suppliers thereafter, and *vice versa*. This form of the test has been named the 'disjunctive' test.

It has been argued that a 'combined alternative' test would be problematic since it could result in a situation where a measure applying to 'unlike' market suppliers could be invalidated merely because it indirectly affects trade in services. Nicolaïdis and Trachtman, for instance, offer the example of a measure that 'requires a bank to maintain reserves different from those maintained by an insurance company before making a loan based on the 'likeness' of the services and despite the unlikeness of the suppliers'.[342] Such an outcome ought to be rejected. On the other hand, a 'disjunctive' alternative test would allow the Member States to treat 'unlike' market suppliers differently *even if* the services they supply are 'like'. In the light of our aforementioned analysis which

340 Report to the Trade Negotiations Committee meeting at Ministerial level, Montreal, December 1988, MTN.GNS/21 (25 November 1988) [11].

341 Diebold, *Non-discrimination in International Trade in Services: "Likeness" in WTO/GATS* (n 69) 209.

342 Nicolaïdis and Trachtman (n 327) 254.

promotes the regulatory freedom of host States to draw regulatory distinctions between market suppliers, the 'disjunctive alternative' test is much more appropriate.

### 4. SWFs and Regulatory Distinctions under the GATS

Our analysis of the GATS indicates that there is a very strong argument for allowing host States to draw regulatory distinctions between SWFs and other market suppliers.

First of all, the GATS explicitly extends its scope of application to market suppliers as the *quid pro quo* for being exposed to the regulatory jurisdiction of the host State—at least under Modes 3 and 4. Such a development necessitates the application of a 'diagonal' comparison when determining the existence of 'less favourable' treatment, a test which could be quite intrusive to the regulatory freedom of the host State. Therefore, this 'liberalising' element would need to be counterbalanced by others that increase the regulatory space of host States, so that the overall balance can be maintained.

Furthermore, economic theory indicates that governmental regulation is much more necessary in the field of services and that States should have an increased regulatory space in order to fulfil their function. This further reinforces the need for an interpretation that permits the drawing of regulatory distinctions.

Our interpretation, which has drawn inspiration both from the GATT and the International Investment Regime, is suggesting that for a measure to be considered 'less favourable', the relevant services and service suppliers need not only be in a competitive relationship. It is further necessary that they are 'like' from a 'regulatory' or 'policy' perspective. Indeed, the presence of regulatory 'likeness' is a *conditio sina qua non* and not just an element to be considered within the 'likeness test'. Last but not least, we put forth an interpretation that allows host States to draw regulatory distinctions between 'policy unlike' market suppliers *even* if the services offered by them are both market and 'policy' like.

Consequently, our interpretation of the GATS would permit host States to differentiate the regulation of SWFs post-establishment in order to address most of their regulatory concerns. Indeed, considerations of market stability, competition policy or even transparency can be addressed through domestic regulation that applies exclusively to SWFs without violating the GATS non-discrimination provisions.

## G. INTERIM CONCLUSION

The construction of the non-discrimination principle under the GATS and under the International Investment Regime arguably constitutes the most important issue relevant to the operation of SWFs in foreign markets. The principle is very important given that it governs measures enacted by the host States at the post-establishment stage of investments in the field of services by SWFs.

The high degree of uncertainty surrounding the principle, however, could be a partial explanation of why host States seem to be very reluctant to admit SWFs' investments into their territories. Arguably, the political sensitivity of this class of investors demands Member States to have a high degree of autonomy to regulate and supervise their operation within their markets. If the principle accords host States enough regulatory space to address their legitimate regulatory concerns post-establishment, then addressing these issues through foreign investment screening mechanisms pre-establishment becomes unnecessary from a normative perspective.

Our hypothesis was that the way the principle has been interpreted so far, drawing heavily from the GATT, is inappropriate to accommodate these legitimate regulatory concerns. In this context, we suggested a modified interpretation of the principle that takes into account regulatory or 'policy' considerations in a dispositive fashion. Such an interpretation is apposite for both the International Investment Regime and the GATS. In fact, we drew inspiration from the former to interpret the latter.

Ultimately, what is submitted is that such a reformulated test would be highly appropriate in the case of SWFs. Host States of SWFs' investments will be able to draw regulatory distinctions between them and other market suppliers or investors and this will alleviate their concerns about their operation within their market. This development is likely to incentivise host States to be more willing to allow SWFs to operate in their markets and move away from the current situation whereby they scrutinise these investments 'at the border' and often block them as a result of protectionist intent or political calculation.

# V. SWFS AND NATIONAL SECURITY EXCEPTIONS

## A. INTRODUCTION

### 1. Defining the Problem

As we analysed in the previous chapters of this thesis, SWF investing activities in the field of services can be covered both by the GATS and a plethora of IIAs. More importantly, there is support for the proposition that IEL instruments cover SWFs' investments not only after their establishment in the host State but also very often at the pre-establishment stage. Furthermore, there is a significant trend in new FTAs with investment chapters to also cover the pre-establishment stage thus according more rights to SWFs.

This more liberal approach of States in the entry and admission of foreign investments is in sharp contrast to their apprehension towards SWFs' investments. Admittedly, there are several legitimate regulatory concerns that surround the operation of these *sui generis* investors, SWFs. As we argued, however, this not need be a problem: the principle of non-discrimination, properly constructed, will permit host States to draw the necessary regulatory distinctions between SWFs and other market actors.

Regrettably, host States have instead responded to this threat by framing their concerns in the language of 'national security'. They have set up – or extended the mandate of – foreign investment screening mechanisms that can interfere with both an incoming and an already established investment on national security grounds. Since, as argued, this interference could *prima facie* amount to a violation of several substantive provisions of IEL, host States have invoked national security to justify their existence and mandate. Most IEL instruments contain national security exceptions that can justify potential violations of the rest of the substantive provisions of the relevant Agreement. The question then that naturally arises is: if foreign investment screening mechanisms − and other relevant regulatory measures − could *prima facie* be in violation of the GATS and IIAs, could they then be subsequently excused under the national security exceptions of IEL, as a matter of law?

### 2. The Concept of 'National Security' in International Law

Before we attempt to answer this question, it is worth delineating the term National Security as has been conceptualised in International Law. National security is a notion that goes at the very core of Sovereignty. As such, States are unwilling to 'tie their hands' with binding rules of international law and dispute settlement when it comes to issues that involve their security interests. Their practice has even given rise to a principle of customary international law according to which, a situation involving a grave and imminent threat to national security creates a state of necessity that precludes the wrongfulness of an act otherwise inconsistent with that State's international obligations.[1] Indeed, national security has even been described as the 'Achilles' heel of international law'—a loophole in disguise.[2]

Despite the profound importance of the concept in International Law – as well as in Philosophy − defining it is a particularly complex and daunting task, given its broad and inherently ambiguous nature. Indeed, the absence of serious conceptual work on the notion has not gone unnoticed.[3]

The Oxford English Dictionary defines national security as the 'safety of a nation and its people, institutions etc., especially from military threat or from espionage, terrorism, etc.'.[4] This rather wide definition, however, could in principle permit anything under the sun. Arguably, trade in and of itself could constitute 'national security', as it could amount to paying a possible 'enemy' for importing its products.

Even descriptively however, the exact content of the notion has evolved over time, in line with societal changes. In this context, it has been suggested that it could now include a wide array of factual circumstances, such as the spreading of diseases, natural disasters, civil strife, economic crises or even foreign control of vital national industries.[5]

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1 Article 25, Articles on Responsibility of States for Internationally Wrongful Acts, GA Res 56/83, UN GAOR, 56th Sess, 85th plen mtg, Supp No 49, UN Doc A/RES/56/83 (adopted 12 December 2011) which states that: '(a) [i]s the only way for the State to safeguard an essential interest against a grave and imminent peril; and (b) [d]oes not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole'; see also *Gabcikovo – Nagymaros Project (Hungary v Slovakia)* (Judgment) [1997] ICJ Rep 7, 40 which recognised that Article 25 reflects customary international law.

2 Hannes L Schloemann and Stefan Ohlhoff, '"Constitutionalization" and Dispute Settlement in the WTO: National Security as an Issue of Competence' (1999) American Journal of International Law 424, 426.

3 Peter Digeser, 'The Concept of Security', paper delivered at the 1994 Annual Meeting of the American Political Science Association, 14 September 1994 who suggests five possible explanations for the neglect of 'security' *cited in* David A Baldwin, 'The Concept of Security' (1997) 23 Review of international studies 5, 9.

4 *Oxford English Dictionary* (2nd edn, Oxford University Press 1989).

5 UNCTAD, *The Protection of National Security in International Investment Agreements* (United Nations, New York and Geneva, 2009) 7; for further discussion on the definitions of the term 'security' see Sharon L Caudle, 'National Security Strategies: Security from What, for Whom, and by What means' (2009) 6

Indeed, one author offers a more modern definition of the term, reflecting a more multidimensional character:

> National security entails the pursuit of psychological and physical safety, which is largely the responsibility of national governments, to prevent both direct and indirect threats and risks primarily from abroad from endangering the survival of these regimes, their citizenry, or their ways of life.[6]

Whilst some of the suggestions to widen the scope of the concept appear reasonable and ought to be accepted in the face of wider societal changes, not all of them are uncontroversial. Some attempts to widen the scope of the notion by elevating certain factual situations to the status of a national security threat might be problematic as a matter of law. The concept of 'national security' in international law reflects a carefully crafted equilibrium between the autonomy of States and the restraints placed upon them, as a result of obligations assumed by them. In that sense, national security serves as an 'exception' that allows States to insulate their action from scrutiny under other rules of international law. Excessively widening the scope of the term could upset the balance between different, and often conflicting, regulatory objectives that has been struck at the international plane. This additional leeway could allow States to pursue potentially unlawful or internationally inefficient policies.

As a matter of fact, this tension is particularly prevalent in the field of IEL. Namely, in situations where national security is perceived as being threatened, States very often use economic policy as an instrument to inflict damage to their opponent.[7] Trade embargoes have been a *leitmotif* throughout history – usually constituting the *ultimum refugium* of foreign policy – falling only short of an actual use of force in terms of disruption. Indeed, as has been observed, a targeted ban on goods and services is one of the most disrupting trade restrictions since it diverts trade through 'an opaque and

Journal of Homeland Security and Emergency Management 1, 4; see also Joseph J Romm, *Defining National Security: Nonmilitary Aspects* (Council of Foreign Relations Press 1993); Arnold Wolfers, 'National Security as an Ambiguous Symbol' (1952) 67 Political Science Quarterly 481.

6 Michael Evans, 'Towards an Australian National Security Strategy: A Conceptual Analysis' (2007) 3 Security Challenges 113, 123.

7 See, eg, Ronald Findlay, *Eli Heckscher, International Trade, and Economic History* (MIT Press, Cambridge 2006); Lucia Coppolaro and Francine McKenzie, *A Global History of Trade and Conflict Since 1500* (Palgrave Macmillan 2013).

burdensome mechanism' that rewards 'less efficient competitors from non-targeted countries'.[8]

Interestingly, the fact that these two goals appear to be in tension with each other had already been observed centuries ago. In his seminal work, '*The Wealth of Nations*', even Adam Smith proclaimed that there is one instance where even the rules of free trade should be bent and the government be legitimately engaged: the protection of national defence.[9] As has been succinctly put, 'trade liberalisation and international regulation does not prevail over Members' vital interests in maintaining the core of sovereignty and cannot restrain Members' freedom to preserve, and defend, their very existence'.[10]

In light of this still widely held principle, defining the exact content and boundaries of national security becomes an issue of cardinal importance.

## 3. National Security in IEL and SWFs

This problem has recently been highlighted as a result of globalisation and the liberalisation project, as promoted through international economic institutions. The integration of national economies has aggravated the tension between the pursuit of national interests and the promotion of open, interconnected and free markets in goods, services and investment.

For instance, and relevantly for the purposes of this thesis, while national security concerns in relation to foreign investment are not new, cases where foreign investors have been rejected for security reasons have become more frequent. It has been suggested that this can be attributed to several factors,[11] but two of the reasons that have been put forth are especially pertinent to this thesis. First of all, the wave of privatisation that has taken place over the past few decades has made States wary that many of their industries – usually described as 'strategic' – could fall under foreign ownership and this

8 Roger P Alford, 'The Self-Judging WTO Security Exception' (2011) Utah Law Review 697, 701.

9 Indeed, in the context of examining Great Britain's legislative measures on navigation that imposed a trade embargo against Holland even though the two countries were not at war, he noted that obviously these laws were 'not favourable to foreign commerce, or to the growth of that opulence that can arise from it' but 'as defense […] is of much more importance than […] opulence […] the act of navigation is, perhaps, the wisest of all commercial regulations of England', Adam Smith, 'An Inquiry Into the Nature and Causes of the Wealth of Nations' Strahan and Cadell, London, Books IV-V, 464.

10 Thomas Cottier and Panagiotis Delimatsis, 'Article XIVbis GATS' in Rüdiger Wolfrum, Peter-Tobias Stoll and Clemens Feinäugle (eds), *WTO – Trade in Services, Max Planck Commentaries on World Trade Law Series* (Martinus Nijhoff 2008) 329–348, 329.

11 See UNCTAD (n 5) xiv–xv.

could expose them to security risks. Secondly, the proliferation and more active role of SWFs have aggravated national security concerns in relation to foreign investment. As we explained earlier, one of the concerns surrounding the operation of SWFs is that they could use their financial strength to affect political outcomes. Nevertheless, restrictions on foreign investors, such as SWFs, when investing in strategically important industries or because of other political considerations is verging on protectionism—a practice that States have pledged to abandon. Indeed, it is one thing to acknowledge a State's sovereignty in matters of war and peace but another to recognise the priority of state interests in relation to strategic industries. In the latter case, the boundaries with economic protectionism are to the very least blurred.[12] This 'recalibration' of the system to find a new balance between investment openness and national security – in an effort to sustain the gains of the former whilst still fortifying the defence of the latter – has been described by Cohen as the new 'Great Tradeoff'.[13]

Therefore, what becomes important is to properly define legitimate security concerns in the context of trade and investment agreements. The fact that States have raised a number of concerns regarding the operation of SWFs in their markets and have occasionally blocked their investments on the basis of national security does not automatically excuse their behaviour or render their actions immune from review under IEL.

Even this 'grey area' of IEL can be elucidated and a proper balancing of these competing interests can be achieved. Indeed, commercial and security interests are very often overlapping and intertwined but this ought not to preclude any attempt at disentangling them or clarifying the rules of engaging with them. The fact that considerations of national security ought to take priority over efficiency and other economic considerations is not disputed. However, there are several options that need to be explored and could prevent the issue of national security exceptions from becoming a 'black and white' matter. Such options would strike a fair balance between the interests of the States and of SWFs.[14]

12 ibid 26.

13 Benjamin J Cohen, 'Sovereign Wealth Funds and National Security: The Great Tradeoff' (2009) 85 International Affairs 713, 722.

14 UNCTAD (n 5) xx.

*In concreto*, what will be submitted is that the situations under which national security exceptions can lawfully be invoked are much more limited that what host States make them out to be. Indeed, the scope of national security exceptions is rather limited and most regulatory concerns regarding SWFs would not fall within their ambit. As a result, the exceptions are not wide enough to cover all the powers of foreign investment screening mechanisms.

The first issue that will be clarified is that the invocation of a national security exception does not deprive the competent dispute settlement organ of its jurisdiction and does not render the dispute non-justiciable. Indeed, under a proper construction of these exceptions under the VCLT, taking into account the relevant state practice and case law, it is submitted that dispute settlement bodies would have to review the invocation of national security exceptions since a) the exceptions do not 'remove' the jurisdiction of panels and arbitral tribunals; and b) the disputes are justiciable. Furthermore, from a substantive perspective, it will be argued that: a) the exceptions, in most cases, have an objective justiciable element; b) the relevant state practice/*travaux* indicate that the exceptions could only excuse measures strictly connected to national security and not measures that have both a national security and a protectionist objective; and c) even if we interpret the provisions in a very deferential fashion, the limit would necessarily be good faith and the facts so far indicate that the States have usually not been acting in good faith when blocking SWFs investments.

The conclusion we can draw from this analysis, however, is not that host States ought to be prevented from regulating the operation of SWFs in their markets. The more modest claim is that it is in only limited instances that blocking SWFs' investments would actually constitute the expression of a legitimate security concern. These cases do exist but are few, marginal and would be excused under even the most stringent national security exception. In most cases, however, the operation of SWFs raises both security as well as other legitimate regulatory concerns. The majority of these concerns could be addressed through domestic regulation and any differential treatment between SWFs and other investors/traders could be excused under a properly constructed principle of non-discrimination, as argued in the previous chapter.

## B. NATIONAL SECURITY EXCEPTIONS IN WTO LAW

### 1. Introduction

The previously described strenuous relationship between National Security and Economic Welfare was obviously well observed at the time of the creation of the GATT, let alone the WTO a few decades later. Member States were aware that economic interdependence naturally enhances a country's security vulnerability. This strategic vulnerability, however, is the necessary price to pay for increased efficiency and overall welfare, the overarching purposes of the WTO. The drafters of the Treaty anticipated this trade-off and, in fact, it was mostly perceived as a welcome development, in the aftermath of WWII.[15] The result of this compromise was Article XXI of the GATT, the venture point of our analysis.

As will become evident later on, this Article is not unambiguous and the proper balance between the competing interests of trade liberalisation and national security largely depends on its precise construction. Indeed, quite early on, Professor Jackson expressed its concern about the future use of Article XXI, albeit recognising the legitimate role it has to play:

> In addition to possible abuse for international political reasons, Article XXI may also shelter some measures that, although ostensibly imposed for security reasons, may actually be protectionist oriented.[16]

The advent of SWFs has further accentuated the tension between these two competing interests and has underlined the need to elaborate on their exact relationship.

### 2. Article XIV$^{bis}$ of the GATS and Article XXI of the GATS

For the purposes of this thesis, what we are concerned about is the national security exception of the GATS, as codified in Article XIV$^{bis}$. The provision provides that:

> 1. Nothing in this Agreement shall be construed:

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15 See, eg, US Secretary of State Hull, Cordell Hull and Andrew Henry Thomas Berding, *The Memoirs of Cordell Hull*, vol 1 (Macmillan New York 1948) 75 who proclaimed:

> I have never faltered, and I will never falter, in my belief that enduring peace and the welfare of nations are indissolubly connected with friendliness, fairness, equality and the maximum practicable degree of freedom in international trade.

16 John H Jackson, *World Trade and the Law of GATT* (Michie Company Law Publishers 1969) 752.

> (a) to require any Member to furnish any information, the disclosure of which it considers contrary to its essential security interests; or
>
> (b) to prevent any Member from taking any action which it considers necessary for the protection of its essential security interests:
>
> (i) relating to the supply of services as carried out directly or indirectly for the purpose of provisioning a military establishment;
>
> (ii) relating to fissionable and fusionable materials or the materials from which they are derived;
>
> (iii) taken in time of war or other emergency in international relations; or
>
> (c) to prevent any Member from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.
>
> 2. The Council for Trade in Services shall be informed to the fullest extent possible of measures taken under paragraphs 1(b) and (c) and of their termination.[17]

An immediate observation is the considerable degree of textual similarity between Article XXI GATT [18] and Article $XIV^{bis}$ of the GATS, strongly suggesting that

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17 Article $XIV^{bis}$, General Agreement on Trade in Services, April 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, The Legal Texts: the Results of the Uruguay Round of Multilateral trade Negotiations 284 (1999), 1869 UNTS 183, 33 ILM 1167 (1994).

18 Article XXI, General Agreement on Tariffs and Trade 1994, April 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, The Legal Texts: the Results of the Uruguay Round of Multilateral Trade Negotiations 17 (1999), 1867 UNTS. 187, 33 ILM 1153 (1994) which reads as follows:

> Nothing in this Agreement shall be construed to require any contracting party to furnish any information the disclosure of which it considers contrary to its essential security interests; or
>
> (b) to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests
>
> (i) relating to fissionable materials or the materials from which they are derived;
>
> (ii) relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment;
>
> (iii) taken in time of war or other emergency in international relations; or to prevent any contracting party from taking any action in pursuance of its

interpretations and case law under Article XXI GATT are relevant and ought to be taken into account – if not constitute the basis of – any attempt to interpret Article XIV$^{bis}$.[19] Indeed, there seems to be no reason why the two provisions ought to be interpreted differently at all. Therefore, and since Article XIV$^{bis}$ has not been invoked in any disputes yet, we will analyse the disputes and literature under Article XXI of the GATT and use them as a template for the interpretation of Article XIV$^{bis}$.

Secondly, it has to be noted that Article XIV$^{bis}$:2 GATS also imposes a notification obligation on Member States. Therefore, Members have to notify the Council for Trade in Services of those measures that they have taken that would be justified under the security exception to the 'fullest extent possible'. The wording of the provision seems to be an 'obligation of best endeavours' and, thus, should probably not be applied very strictly. In any case, it is difficult to see what would the consequence for its violation; arguably none, since it is not a precondition for the justification of the measure but rather a separate obligation. Thus, it is reasonable to assume that the notification can take place after the enactment of the measure.[20] In any case, no Member State has notified the GATS Council of any foreign investment screening mechanisms or similar schemes as of yet.

Thirdly, and most importantly, a relatively safe conclusion we can draw is that the Member States opted for a wording that renders the exception 'self-judging' to a certain degree. Indeed, the phrase 'it considers' contained in the second paragraph indicates that at least the notion of 'essential security interests' does not have an autonomous meaning.

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> obligations under the United Nations Charter for the maintenance of international peace and security.

19 For an argument by analogy see *US – Measures Affecting the Cross-Border Supply of Gambling and Betting Services* WTO Appellate Body, WT/DS285/AB/R, adopted 20 April 2005, DSR 2005:XII, 5663 (Corr1, DSR 2006:XII, 5475) [291] where the AB made a similar proclamation about Article XX GATT and Article XIV GATS:

> Article XIV of the GATS sets out the general exceptions from obligations under that Agreement in the same manner as does Article XX of the GATT 1994.

See also *EC – Bananas III* WTO Appellate Body, WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591 [231] where the Appellate Body encourages Panels that tackle GATS claims to refer to the GATT only where the obligations are essentially of the same type.

20 See Notification Pursuant to Article XXI of the GATT 1994 and Article XIVbis of the GATS, Nicaragua, G/C/4, S/C/N/115 (21 February 2000).

Somewhat curiously, the ICJ in its seminal *Nicaragua v USA* case[21] drew a distinction between the 'objective language' contained in the US-Nicaragua FCN Treaty and the self-judging language in Article XXI of GATT:

> […] by the terms of the [FCN] Treaty itself, whether a measure is necessary to protect the essential security interests of a party is not… purely a question for the subjective judgment of the party; [unlike GATT] the text does not refer to what the party 'considers necessary' for that purpose.[22]

Therefore, it seems that the ICJ has implicitly recognised this somewhat self-judging character of the provision.[23]

The problem, of course, is determining the degree to which this provision is self-judging and the legal consequences that flow from it. Indeed, it is disputed whether the decision of a Member State to invoke the security exception would completely escape any scrutiny or whether there are some 'outer limits' to that discretion that ought to be respected.[24]

The traditional means of treaty interpretation naturally ought to be the venture point of such an interpretative exercise. Unfortunately, the 'ordinary meaning' of the phrase 'it considers' is not really that clear since it could be taken to inform the whole, or just part of Article XXI(b).[25] If the 'it considers phrase' informs the whole Article then, arguably, the existence of the predefined conditions as well as whether their invocation is made in good faith would be left entirely within the discretion of the State. Consequently, it has even been suggested that the self-judging nature of this exception would render any claims inadmissible or any disputes non-justiciable. If, however, the phrase informs only the first part of the phrase (namely that the measure is necessary for the protection of the

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21 *Military and Paramilitary Activities in and Against Nicaragua (Nicaragua v United States)* (Merits) [1986] ICJ Rep 14.

22 ibid [282].

23 *Cf Oil Platforms (Islamic Republic of Iran v United States of America)* (Merits) [2003] ICJ Rep 161 [43] where the ICJ interpreted the security exception, which was lacking a similar 'self-judging' language, in the Iran-United States FCN Treaty as incorporating an objective standard subject to judicial review when it stated that 'whether a measure is "necessary" is "not purely a question for the subjective judgment of the party and may thus be assessed by the Court'.

24 See also Schloemann and Ohlhoff (n 2) 426 *et seq*. who distinguish between Article XXI as a 'jurisdictional defense' from the scope of its 'substantive reach'. These differences will be analysed later on in this chapter.

25 Alford (n 8) 706.

State's essential security interests) then we could arguably identify an 'objective core', the invocation of which is justiciable.

These different interpretative approaches have important ramifications for the architecture of the system, in general, and the leeway Member States enjoy when dealing with SWFs, in particular. In the following sections, the historical context and practice of States will be analysed. Subsequently, the conclusions we have drawn from this exercise will inform the interpretation of the national security exception. Ultimately, and as an outcome of this exercise, a construction of the provision will be put forth according to which a certain degree of review of the Member State's decisions is indeed permitted.

### 3. Historical Context

The preparatory work of the GATT/WTO Agreements constitutes an important consideration in the attempt to interpret the security exceptions properly. Indeed, in the context of WTO law, the AB and Panels have − albeit only *occasionally* − given preparatory work the interpretative weight of context,[26] rather than that of supplementary means of interpretation, as the VCLT dictates.[27] On the other hand, it has also been suggested that 'there is generally something in the *travaux préparatoires* that can be found to support almost any contention'[28] and that its role ought to be one of

[26] In the case of WTO, there is perhaps an in-built tendency to attach more weight to preparatory works that originated during the GATT years and the panels' tendency to favour negotiating history in interpreting the GATT 1947; for more on this issue see Pieter Jan Kuijper, 'The Law of GATT as A Special Field of International Law: Ignorance, Further Refinement or Self-contained System of International Law?' (1994) 25 Netherlands Yearbook of International Law 227, 229; Pieter Jan Kuijper, 'Panel Discussion: WTO Case Law in an International Context' in Merit E Janow, Victoria Donaldson and Alan Yanovich (eds), *WTO at Ten: Governance, Dispute Settlement and Developing Countries* (Juris Publishing, Huntington 2008) 722, 722–723; also, for recent cases where the influence of preparatory work seems to still be substantial see *Chile – Price Band System* Appellate Body Report, Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products, WT/DS207/AB/R, adopted 23 October 2002, DSR 2002:VIII, 3045 (Corr1, DSR 2006:XII, 5473) [200] and [230]–[234]; *EC – Tariff Preferences* Appellate Body Report, European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries, WT/DS246/AB/R, adopted 20 April 2004, DSR 2004:III, 925 [107]–[108] where the special character of the enabling clause was clarified with the aid of preparatory work.

[27] This should not be necessarily considered problematic since the boundaries between primary and supplementary means of interpretations were not meant to be very rigid; see 'Draft Articles on the Law of Treaties with commentaries 1966, as part of Report of the International Law Commission on the work of its eighteenth session (4 May–19 July 1966), Doc. A/6309/Rev.1' (1996) II Yearbook of the International Law Commission 172, 220.

[28] Sir Eric Beckett, 'Observations des membres de la Commission sur le rapport de M. Lauterpacht – 1. Comments by Sir Eric Beckett' (1950) 43 Annuaire de l'Institut de Droit International 435, 440.

'justification and confirmation rather than elucidation'.[29] Therefore, it is submitted that an inquiry into the *travaux* is necessitated but it is in no way authoritative in this exercise.

In the context of our discussion, it is worth noting that the negotiators were also concerned about what the possible ramifications of the security exception. These concerns were already recognised at an early stage and the negotiators indeed expressed their fear that a very vaguely constructed exception would turn into 'a very big loophole in the whole [GATT] Charter'.[30] Even though it is clear that many of the WTO Member States did actually embrace the suggestion that there should be some leeway in their invocation of the security exception, it was also clear that a 'frequent or abusive use of this prerogative would undermine the cooperation and obligations that attach under the GATT'.[31]

Interestingly, even the United States shared that concern at the time proclaiming that a wide construction would permit 'anything under the sun'.[32] A sceptical Argentinian delegate once noted that Article XXI of the GATT is a 'magnificent safeguard clause' that allows any country to take action without it 'having to be justified or approved' by anyone.[33] In an ironic twist of events, his country became probably the most fervent supporter of non-reviewable security exceptions both in the aftermath of the Falklands War[34] and later during the 2011 Argentinian Sovereign Debt crisis.[35]

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29 Isabelle Van Damme, *Treaty interpretation by the WTO Appellate Body* (Oxford University Press 2009) 315.

30 Dr Speekenbrink on behalf of the Netherlands, Economic & Social Council United Nations, Preparatory Committee of the UN Conference on Trade & Employment, Thirty-Third Meeting of Commission A, UN Doc E/PC/T/A/PV/33 (1947) 19.

31 Peter Lindsay, 'The Ambiguity of GATT Article XXI: Subtle Success or Rampant Failure?' (2003) 52 Duke Law Journal 1277, 1299.

32 Mr Leddy, an official of the United States Department of State and a Rapporteur of the Legal Drafting Group of the GATT, on behalf of the United States; see GATT, Analytical Index: Guide to GATT Law and Practice 600 *citing* verbatim *Report of the Preparatory Committee of the UN Conference on Trade and Development*, UN ESCOR, 2nd Session, 33rd meeting, Corr 3 UN Doc E/PC/T/A/PV/33 (1947) 20–21.

33 Minutes of Meeting Held in the Centre William Rappardon 7 May 1982, C/M/157 (22 June 1982), 12.

34 See *infra* fns 48−52 and accompanying text.

35 See the Argentinian arguments in *CMS Gas Transmission Company v Republic of Argentina* (ICSID Case No ARB/01/8) Award, 12 May 2005; *Enron Corporation and Ponderosa Assets, LP v The Argentine Republic* (ICSID Case No ARB/01/3) Award, 22 May 2007; *Sempra Energy International v Argentine Republic* (ICSID Case No ARB/02/16) Award, 28 September 2007; *LG&E Energy Corp, LG&E Capital Corp and LG&E International Inc v Argentine Republic* (ICSID Case No ARB/02/1) Award, 25 July

In that context, it seems that the delegates decided to maintain a self-judging security exception but also to limit the invocation of such an exception in some specific and limited circumstances, such as war or international emergencies.[36] The US delegate succinctly explained the spirit of the formulation:

> [W]e cannot make it so broad that, under the guise of security, countries will put on measures which really have a commercial purpose […].[37]

Therefore, a provisional conclusion we can draw from the historical context of the Agreement is that the States probably intended for a National Security exception that would offer a considerable amount of regulatory discretion but would not go as far as being completely immune from any scrutiny and would certainly not cover 'commercial considerations' of any kind.

### 4. State Practice

In attempting to interpret the provisions of the WTO Agreements, Article 31(b) of the VCLT directs us to take into account 'any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions' and any 'subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation' in line with Article 31(3)(b) of the VCLT.[38]

In general, even though the security exception provisions seem to *prima facie* provide a lot leeway to Member States, they have been invoked only exceptionally. To date, there has been no WTO or GATT Panel settling the issue or even indirectly commenting on the interpretation of Article XXI. It has been argued that this is probably due to mutual deterrence, reputation costs, and the existence of a common interest in complying with GATT obligations.[39] Irrespective of why States have not made formal

2007; *Continental Casualty Company v The Argentine Republic* (ICSID Case No ARB/03/9) Award, 5 September 2008.

36 Alford (n 8) 699.

37 See GATT, Analytical Index: Guide to GATT Law and Practice (n 32) 20–21.

38 Vienna Convention on the Law of Treaties (adopted 22 May 1969, entered into force 27 January 1980) 1155 UNTS 331, Article 31(3)(b); this argument is further reinforced in the context of the WTO since Article XVI of the WTO agreements stipulates that 'the WTO shall be guided by the decisions, procedures and *customary practices* followed by the CONTRACTING PARTIES to GATT 1947 […]' (emphasis added), Marrakesh Agreement Establishing the World Trade Organization, April 15, 1994, 1867 UNTS 154, 33 ILM 1144.

39 Louis Henkin, *How Nations Behave: Law and Foreign Policy* (Columbia University Press 1979) 46–53.

use of the provision though, there have been several disputes where the card of national security was played and the invocation of the exception was threatened. These cases do constitute relevant State practice and ought to be examined since they could potentially reveal a lot about how the States perceive the national security exception. Furthermore, irrespective of what the Parties have actually said (or rather not said) in these cases, it is the substantive content of their behaviour which forms the relevant State practice for the purpose of interpreting the security exception's *material content*.[40]

*(i) Czechoslovakia v the USA*

The first time a situation that could potentially engage the GATT national security exception arose, was Czechoslovakia's challenge of export controls under the Marshall Plan, as an MFN violation. Czechoslovakia argued for a restrictive interpretation of Article XXI since otherwise 'practically everything may be a possible element of war'.[41] This is an especially interesting case since Czechoslovakia implicitly challenged the self-judging character of the second part of the provision, namely the explicitly enumerated conditions under which Article XXI can be engaged. The US defended the measure on the basis that the export controls concerned goods that appeared to be intended for peaceful use but could, in fact, have military applications. Ultimately, the members of the GATT unanimously rejected the establishment of a Panel to adjudicate upon the matter (with 3 members abstaining).[42] Reading between the lines, however, we can discern that the US based its defence on the potential dual-use of the goods whose exportation was restricted, thus *substantively* defending the measure, and not on the absolute self-judging nature of the GATT security exception. This should be taken as evidence that at least in the early days of the GATT there was some understanding that the provision should not be used as an all-encompassing trump card and that there are some limits to its invocation.[43] The historical context of the time only reinforces the

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40 Sir Ian McTaggart Sinclair, *The Vienna Convention on the Law of Treaties* (2nd edition, Manchester University Press 1984) 137.

41 Statement by the Head of the Czechoslovak Delegation Mr Zdenk Augenthaler to Item 14 of Agenda, Request of the Government of Czechoslovakia for a Decision Under Article XXIII as to Whether or Not the Government of the United States of America Has Failed to Carry Out Its Obligations Under the Agreement Through Its Administration of the Issue of Export Licenses, CP.3/33 (30 May 1949) at 5, 12.

42 GATT Contracting Parties, Summary Record of the Twenty-Second Meeting, CP.3/SR.22 (8 June 1949) 9.

43 See Raj Bhala, 'National Security and International Trade Law: What the GATT Says, and What the United States Does' (1998) 19 University of Pennsylvania Journal of International Economic Law 263, 278–279 who considers this and 1982 decision in the Falkland context as sufficient precedent that the

strength of the argument; if the US was not willing to make that argument in order to defend its flagship post-War project – the Marshall Plan – it's difficult to see how that argument can maintain its persuasion in the case of blocking SWFs investments.

*(ii) Swedish Import Restrictions on Footwear*

A few years later, Sweden tried to defend the maintenance of an import quota system on footwear as necessary for reasons of national security. The extremely interesting aspect of this justification, though, was Sweden's attempt to expand to definition of national security in order to cover situations that could be described as instances where 'economic security' was threatened. It contended that:

> [The] decrease in domestic production has become a critical threat to the emergency planning of Sweden's economic defence as an integral part of the country's security policy […]. Such [domestic production] capacity is indispensable in order to secure the provision of essential products necessary to meet basic needs in case of war or other emergency in international relations.[44]

Other Member States disapproved the justification of this measure on the basis of Article XXI and questioned its validity,[45] something that resulted in consultations and, eventually, the withdrawal of the measure within 2 years.[46] From this incident we can make two relevant observations. Firstly, even during the GATT years when the system was much more political than judicial, Article XXI was not perceived as trump card to escape GATT obligations and some limits to its invocation were recognised.[47] Secondly,

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GATT/WTO jurisdiction under Article XXIII for matters involving Article XXI cannot be disputed; see however Schloemann and Ohlhoff (n 2) 432, at fn 43 who argue that the Parties at the time, when deliberating on these issues, were only thinking of themselves as a diplomatic and not a judicial body and that, as a consequence, their opinions are of limited precedential legal value.

44 GATT, Analytical Index: Guide to GATT Law and Practice (n 32) 603 (quoting GATT Doc L/4250, 3).

45 John A Spanogle, 'Can Helms-Burton Be Challenged under WTO' (1997) 27 Stetson Law Review 1313, 1331

46 The measure was withdrawn on 1 July 1 1977; see GATT, Analytical Index: Guide to GATT Law and Practice (n 32) 603.

47 Note, however that, in the early years of the GATT and in the aftermath of WWII, there was always the possibility of two Members of the Agreement not willing to have any trade relations between them, as sanctioned under Article XXXV or 'Non-application' clause:

> 1. This Agreement, or alternatively Article II of this Agreement, shall not apply as between any contracting party and any other contracting party if:

and perhaps more importantly, this first attempt to conceptualise economic interests as a potential subcategory of national security interests (albeit in limited occasions) was vehemently refuted by the other Members and ultimately rejected. This issue came to the forefront in the context of the 'economic necessity' defence invoked by Argentina after its sovereign debt crisis but it is also very relevant in the case of SWFs. Arguably, the political sensitivities that surround the operation of SWFs in developed markets have to a significant extent more to do with issues of vital or sensitive 'economic interests' rather than security interests *stricto sensu*.

*(iii) Argentina and the Falklands War*

Another interesting case where Article XXI was invoked was that of the Falklands War and the trade embargo that the EEC (along with Australia and Canada) imposed on Argentina at the time.[48] Shortly afterwards, the GATT Council convened to address Argentina's protestations that the trade embargo could not be justified under Article XXI of the GATT.[49] In that meeting, 20 countries defended the measure on the basis of it falling beyond the GATT's competence whilst 6 countries argued that it is subject to GATT review and another 11 countries did not comment on the issue.[50] Contrary to the two previous disputes, the practice of States in this instance seems to indicate that Article XXI was perceived to be self-judging by the Membership of the GATT at the time.[51] It should be noted, however, that in this specific situation the measure in question would clearly fall within Article XXI's explicitly enumerated conditions so perhaps some Members did not want to make a point of principle in the very heated international climate of the time. In any case, the Council recognised that trade measures taken for

> (a) the two contracting parties have not entered into tariff negotiations with each other, and
>
> (b) either of the contracting parties, at the time either becomes a contracting party, does not consent to such application.
>
> 2. The CONTRACTING PARTIES may review the operation of this Article in particular cases at the request of any contracting party and make appropriate recommendations.

48 See *Trade Restrictions Affecting Argentina Applied for Non-Economic Reasons* Communication by the Commission of the European Communities, GATT Doc L/5319, 18 May 1982.

49 See *Trade Restrictions Affecting Argentina Applied for Non-Economic Reasons* Communication by Argentina, GATT Doc L/5317, 30 April 1982.

50 Alford (n 8) 7.

51 ibid 7.

security reasons 'could constitute, in certain circumstances, an element of disruption and uncertainty for international trade'.[52]

### *(iv) Nicaragua v the USA*

The issue arose again when the US President Reagan found 'that the policies and actions of the Government of Nicaragua constitute an unusual and extraordinary threat to the national security and foreign policy of the United States and […] declare[d] a national emergency to deal with that threat'.[53] Consequently he imposed a trade embargo on Nicaragua in 1985 covering all exports and imports, as well as the provision of all related services.[54]

Similarly, Nicaragua brought the issue at the GATT Council but again the majority of States (19) argued that Article XXI was self-judging. It is worth mentioning however that a significant number of States did not express an opinion. As opposed to the Falklands incident, the United States in this occasion eventually agreed to the formation of a GATT Panel provided 'it was understood that the Panel could not examine or judge the validity of or motivation for the invocation of Article XXI:(b)(3) by the United States in this matter'.[55] Therefore, the establishment of this panel was moribund due to its terms of reference: it concluded that 'it could find the United States neither to be complying

52 See GATT Council, Decision Concerning Article XXI of the General Agreement, GATT Doc L/5426 (2 December 1982).

53 *US –Trade Measures Affecting Nicaragua* Communications from the United States, GATT Doc L/5803, 29 May 1985, restricted, 2.

54 Note that this was the second time that a similar issue arose between the United States of America and Nicaragua. In 1982, the Reagan Administration drastically reduced sugar imports from Nicaragua as a part of its wider agenda on foreign relations with Latin American countries. Nicaragua brought a case against the US that resulted in the formation of a Panel and a defeat for the US. At the time, the US did not specifically invoke the Article XXI exception but it argued that:

> [T]he reduction of Nicaragua's sugar imports was not solely motivated by trade considerations, nor did this actions secure any economic or trade benefit for the United States or for the sugar producers or any other industry of the United States… the united States did not believe that the review and resolution of that broader dispute was within the ambit of the GATT.

For the Panel Report see *US – Sugar Quota* GATT Panel Report, United States – Imports of Sugar from Nicaragua, L/5607, adopted 13 March 1984, BISD 31S/67, *esp*. [3.10]–[3.11] for the aforementioned quote; it should also be noted that the defeat of the US in this case is probably the reason why it explicitly invoked Article XXI in 1985 when a similar situation with Nicaragua arose.

55 See Minutes of Meeting Held in the Centre William Rappard on 10 October 1985, C/M/192 (24 October 1985) 6.

with its obligations under the Agreement nor to be failing to carry out its obligations under the Agreement'.[56]

Arguably, this change in strategy could probably be explained as an expression of the US angst over a potential review of its decision on the merits of Article XXI; indeed, if the US was confident about its jurisdictional immunity it would not have attempted to restrict the terms of reference that would direct the Panel.[57]

The Panel did in fact acknowledge that the invocation of a security exception was a right of each Member State but it expressed concerns about the elimination of any possibility of judicial review[58] and noted that 'further consideration' is warranted in a future 'formal interpretation of Article XXI'.[59] Nonetheless, it noted that if it were to find that the measures had nullified or impaired benefits to Nicaragua under the GATT, then it would have had two options: either to recommend the withdrawal of the measures taken or to authorise Nicaragua to suspend its obligations under the GATT.[60] In the opinion of the panellists though, none of these options would have been effective.[61] On a related, yet interesting, point, the panellists noted that – had there been a violation of the Agreement – they would not have had the right to grant a general waiver to third parties not involved in the matter to offer Nicaragua more favourable treatment in order to compensate for the effects of the embargo.[62]

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56 *US – Trade Measures Affecting Nicaragua* GATT Panel Report, L/6053, 13 October 1986, unadopted [5.3].

57 Schloemann and Ohlhoff (n 2) 434.

58 See *US – Trade Measures Affecting Nicaragua* (n 56) [5.17] where the Panel very succinctly posed 3 questions:

> (1.) provided one accepts that Art. XXI GATT 1947 can be interpreted exclusively by the country invoking it, how could an abuse of this exception be avoided? (2.) to what extent may a complainant affected have its complaint examined under Art. XXIII:2 GATT 1947, when a Panel is not permitted to examine the justification of an Art. XXI GATT 1947 invocation? (3.) do Members have sufficient powers under Art. XXIII:2 GATT 1947 to provide redress to a Member subjected to an embargo prohibiting exports to, and imports from, that Member?

59 ibid [5.17].

60 ibid [5.7].

61 ibid [5.10].

62 ibid [5.13]–[5.14].

### *(v) The LIBERTAD and ILSA Acts: A Change in EC's Practice?*

Up until that point, the United States and the European Community were on the same page insisting on a complete self-judging Article XXI and also highlighting the institutional incompetence of the GATT to deal with issues that touch upon matters of security.[63] This agreement seems to have been somewhat shaken in 1996 when the US Congress passed the Cuban Liberty and Democratic Solidarity (LIBERTAD) Act that imposed severe economic sanctions on Cuba including sanctions on any foreign individual or corporation who 'traffics in property which was confiscated by the Cuban Government on or after January 1, 1959'.[64] This measure was to be broadly interpreted to include any commercial activity relating to the expropriated property[65] and, as a consequence, it would also affect European corporations conducting business in Cuba. During the same year, the Iran and Libya Sanctions Act (ILSA)[66] was also enacted, containing similar extraterritorial measures that affected EU companies.[67]

These measures proved to be highly controversial and even stirred a heated academic debate.[68] In that context, immediately after the enactment of the legislation, the EC filed a request for WTO consultations (since by then the WTO had been established) and expressed the opinion that several aspects of the Act do not conform '[…] to the international obligations of the United States under GATT 1994 and GATS'.[69] Even Canada requested consultations with the US under the NAFTA regarding the Helms-

63 See Alford (n 8) 718, 720.

64 The Cuban Liberty and Democratic Solidarity (Libertad) Act of 1996 (Helms–Burton Act), 22 USC, [6021]–[6091], [6082].

65 ibid [6023].

66 Iran and Libya Sanctions Act 1996, 50 USC 1702, PL 104-172.

67 For more see Bhala (n 43) 253; Rene E Browne, 'Revisiting National Security in an Interdependent World: The GATT Article XXI defense After Helms-Burton' (1997) 86 Georgetown Law Journal 405.

68 See Andreas F Lowenfeld, 'Congress and Cuba: The Helms-Burton Act' (1996) American Journal of International Law 419; Brice M Clagett, 'Title III of the Helms-Burton Act is Consistent with International Law' (1996) 90 American Journal of International Law 434; Brice M Clagett, 'A Reply to Professor Lowenfeld' (1996) American Journal of International Law 641.

69 See *US – The Cuban Liberty and Democratic Solidarity Act* Request for Consultations by the European Communities, GATT Doc WT/DS38/1, 13 May 1996.

Burton Act but failed to pursue the matter further;[70] arguably though, had the dispute reached the dispute settlement stage, Canada would have won.[71]

The stakes were raised even further this time since, under the new rules of the WTO, a panel review was automatic unless the EC settled or withdrew its complaint. Indeed, a WTO Panel was ultimately established and the US declared its concern about the potential adverse consequences that would flow from this development: 'proceeding further with this matter would pose serious risks for this new and invaluable organization, which was only in the early stage of its development'.[72] Ultimately, however, a change in the political climate in the US led President Clinton to waive the effective date of the Act and, thus, to render the issue moot. On 25 1997, the EC notified the WTO that it has requested the Panel to suspend its proceedings while a mutual agreeable solution was to be negotiated.[73] President Clinton promised to amend the Act and remove the provisions most offensive to Europe and, in return, the EC let the deadline for bringing the case before the Panel lapse.[74] Indeed, the US and the EU signed an agreement according to which the effects of LIBERTAD and ILSA on European States and entities would be suspended[75] albeit EU entities were still monitored.[76]

The turn of events indicates that, perhaps with the advent of the WTO, the belief that a completely self-judging security clause could be maintained had started to wane—assuming it ever existed. This can be mainly attributed to two factors. First, the EC − which constituted the second biggest market in the world at the time − had changed its position and would probably accept that Article XXI was, to some extent, reviewable. In

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70 See Stephen J Randall, *A Not So Magnificent Obsession: The United States, Cuba, and Canada from Revolution to the Helms-Burton Law* (19 Canadian-American Public Policy Working Paper No 36, 1998).

71 See Antonella Troia, 'The Helms-Burton Controversy: An Examination of Arguments that the Cuban Liberty and Democratic Solidarity (Libertad) Act of 1996 Violates U.S. Obligations under NAFTA' (1997) 23 Brooklyn Journal of International Law 603.

72 Minutes of Meeting Held in the Centre William Rappard on 20 November 1996, WT/DSB/M/26 (15 January 1997) 2.

73 See Communication from the Chairman of the Panel, United States − The Cuban Liberty and Democratic Solidarity Act, WT/DS38/5 (25 April 1997).

74 See Note by the Secretariat, Lapse of the Authority for Establishment of a Panel, United States – The Cuban and Democratic Solidarity Act, WT/DS38/6 (24 April 1998).

75 Understanding between the European Union and the United States on US extraterritorial legislation (11 April 1997).

76 EU Market Access Database, *Helms-Burton Act*.

fact, the statements of the EC already indicate that it had abandoned its previous arguments about institutional incompetence of the GATT and was willing to now recognise such a role – at least a subsidiary one − to the newly established WTO. Furthermore, the fact that the US eventually suspended the Act, partly having the possibility of WTO litigation in mind,[77] could be taken as evidence that the US recognised that the political climate had now changed and that the strong institutional mechanisms of the newly fledged WTO would now make a review of similar acts unavoidable.

*(vi) Saudi Arabia's Accession to the WTO*

On that note, the most recent situation where Article XXI was implicated probably reinforces the aforementioned view. When Saudi Arabia, after more than 12 years of negotiations,[78] was about to join the WTO, the US pressured the country to terminate the primary boycott of Israel it had been maintaining.[79] Saudi Arabia promised that it would apply 'all WTO rules' to all WTO members including Israel.[80] This in reality constituted a prime example of constructive ambiguity; six months after Saudi Arabia's accession to the WTO, Turki Al-Faisal announced that the primary boycott of Israel would be maintained since it 'is an issue of national sovereignty guaranteed within the makeup of the WTO and its rules'.[81] Both the US House of Representatives[82] and the Bush Administration protested to this[83] but, ultimately, neither the US nor Israel decided to

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77 Alford (n 8) 721.

78 See WTO, General Council Successfully Adopts Saudi Arabia's Terms of Accession, PRESS/420 (11 November 2005).

79 Saudi Arabia had already terminated the application of secondary and tertiary boycotts of Israel both in practice and in law, see Report of the Working Party on the Accession of the Kingdom of Saudi Arabia to the World Trade Organization, WT/ACC/SAU/61 (1 November 2005) 41.

80 Letter from Robert Portman (US Trade Representative) on Saudi Arabia (9 August 2005).

81 See Michael Freund, 'Saudi Ambassador to US Admits Boycott of Israel Still in Force' *Jerusalem Post* (22 June 2006).

82 See *H.R. Con. Res. 370, 109th Cong.* (2006) for the relevant resolution proclaiming that:

> [I]t is the sense of the Congress that… (1) Saudi Arabia should maintain and fully live up to its commitments under the World Trade Organization (WTO) and end all aspects of any boycott on Israel; and (2) the President should urge Saudi Arabia to end any boycott on Israel.

83 Freund (n 81) 186.

take up the matter to the WTO Dispute Settlement System since that would constitute an admission of the justiciability of the security exception.[84]

*(vii) Conclusions*

The disputes described above[85] seem to indicate that GATT/WTO Members have neither a uniform nor a consistent perception of Article XXI. Professor Alford has also performed this exercise very thoroughly but he additionally examined the reactions and statements of the Member States when these situations arose. In that context, he came to several conclusions regarding the practice of States in invoking Article XXI[86] that could assist in at least coming to some preliminary conclusions regarding the interpretation of the national security exception.

First of all, he notes that all States agree that the security exception can only be invoked in good faith but a strong majority maintains that the security exception is entirely self-judging.[87] Secondly, the States that interpret the exception as self-judging are mostly concerned with the need to protect their security interests despite any trade commitments they might have made.[88] Thirdly, the minority of States that reject an interpretation of Article XXI as a self-judging exception are concerned about the possibility of abuse of such an interpretation by economically stronger States.[89]

84 Alford (n 8) 725.

85 It has to be noted that the Panel in *China – Raw Materials* Panel Reports, China – Measures Related to the Exportation of Various Raw Materials, WT/DS394/R / WT/DS395/R / WT/DS398/R / and Corr1, adopted 22 February 2012, as modified by Appellate Body Reports WT/DS394/AB/R / WT/DS395/AB/R / WT/DS398/AB/R [7.276] *incidentally* made a comment on the standard of deference under Article XXI by comparing it to the applicable standard under Article XX indicating it would adopt a very deferential approach:

> The Panel does not consider that the terms of Article XI:2, nor the statement made in the context of negotiating the text of Article XI:2 that the importance of a product 'should be judged in relation to the particular country concerned', means that a WTO Member may, on its own, determine whether a product is essential to it. If this were the case, Article XI:2 could have been drafted in a way such as Article XXI(b) of the GATT 1994, which states: "Nothing in this Agreement shall be construed... to prevent any contracting party from taking any action *which it considers necessary* for the protection of its essential security interests (emphasis in the original).

86 See Alford (n 8) 708–725.

87 Minutes of Meeting Held in the Centre William Rappardon 7 May 1982, C/M/157 (22 June 1982) cited in Alford (n 8) 708.

88 Alford (n 8) 708 *et seq*.

89 ibid 715.

Therefore, a preliminary conclusion we can draw from this exercise is that there is no unequivocal, or at least substantial, subsequent practice of States on this issue that could establish the agreement of the Parties[90] within the meaning of Article 31(3)(b) of the VCLT.[91] Nevertheless, we can discern a definite trend towards a gradual acceptance of the fact that the WTO has a certain role to play in such disputes and a certain acceptance of the inevitability of that happening in the future. Indeed, especially after the 'judicialization' that came with the creation of the WTO, we can at least conclude that a 'water-tight' self-judging national security exception is a thing of the past—not ignoring the fact that the issue has not had a significant practical importance so far. Last but not least, the fact that there has been only one genuine dispute over so many years indicates that the abuse of Article XXI has not been an important issue in practice—perhaps indicating a generally satisfying level of adherence to the rules.

## 5. Foreign Investment Screening Mechanisms and their Lawfulness under the GATS

Having reviewed the relevant historical context and state practice regarding the national security exceptions of the WTO Agreements, we will now attempt to ascertain whether the existence and operation of foreign investment screening mechanisms can be justified under Article XIV$^{bis}$ as well as Article XXIII GATS. In that exercise, the conclusions we have drawn from our previous analysis will inform our suggested interpretation. The main issues that concern the legality of foreign investment screening mechanisms under the GATS are 1) whether Panels would have the competence to review the relevant national security exception; 2) whether Article XIV$^{bis}$ itself offers enough degree of deference that would justify the maintenance of these regulatory schemes; and 3) in case it does, whether their existence would nevertheless constitute a nullification or impairment of benefits under the GATS.

90 Browne (n 67) 422–423; Dapo Akande and Sope Williams, 'International Adjudication on National Security Issues: What Role for the WTO' (2002) 43 Virginia Journal of International Law 365, 374.

91 Article 31(3)(b) VCLT which permits recourse to the subsequent practice of the parties to a treaty as a means of treaty interpretation, where that practice 'establishes the agreement of the parties regarding its interpretation'.

### *(i) Jurisdiction and Justiciability Issues concerning Article XIV$^{bis}$ GATS*

The first question that naturally arises from the language of the provision and the practice of States so far is whether firstly, it affects the jurisdiction of WTO panels and, secondly, whether it renders any disputes concerning national security as non-justiciable.

In response to these questions, there is a school of thought that, with some nuances, supports the view – also supported by some States[92] – that Member States enjoy the full discretion to decide for themselves whether a certain measure is essential to its security interests *as well as* whether it relates to one of the explicitly mentioned situations.[93] The rationale for this approach would be that security issues are ultimately political questions that should be left outside the realm of judicial scrutiny.[94] This rationale becomes more powerful if the relevant claims are 'inextricably linked' to 'other rules of international law', so that passing a judgment on the trade issue would necessarily entail a legal assessment of the wider issue by applying other rules of international law.[95]

From a legal point of view this interpretation is questionable. First of all, it is reasonably clear that the DSU itself is not subject to the security exception[96] and, thus,

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92 Most notably the United States of America—albeit not unambiguously; for a more detailed account of the US position and its context see James Mendenhall, 'The Evolution of the Essential Security Exception in U.S. Trade and Investment Agreements' in Karl P Sauvant, Lisa E Sachs and Wouter P F Schmit Jongbloed (eds), *Sovereign Investment: Concerns and Policy Reactions* (Oxford University Publishers 2012) 310–403.

93 See, eg, Bhala (n 43) 269–269 who concludes that: 'the implication of the word "it" indicates that no WTO Member, nor group of Members, and no WTO panel or other adjudicatory body, has any right to determine whether a measure taken by a sanctioning member satisfies the requirements.'; see also Andrew Emmerson, 'Conceptualizing Security Exceptions: Legal Doctrine or Political Excuse?' (2008) 11 Journal of International Economic Law 135, 142–143; Richard Sutherland Whitt, 'Politics of Procedure: An Examination of the GATT Dispute Settlement Panel and the Article XXI Defense in the Context of the US Embargo of Nicaragua, The' (1987) 19 Law & Policy in International Business 603, 616.

94 For an analysis of this argument see Michael J Hahn, 'Vital Interests and the Law of GATT: An Analysis of GATT's Security Exception' (1990) 12 Michigan Journal of International Law 558, 612–614.

95 See Joost Pauwelyn, Conflict of Norms in Public International Law (Cambridge University Press 2008) 452 see also Dissenting Opinion of Judge Schwebel, *Military and Paramilitary Activities in and Against Nicaragua (Nicaragua v United States)* (Jurisdiction and Admissibility) [1986] ICJ Rep 14, 613 and 616 who, in the context of deciding whether the ICJ should adjudicate upon a dispute that involved wider issues of general and customary international law, stated that:

> Nicaragua's claims are so integrally and essentially bound up with the treaty provisions on which they rely that, if those provisions cannot be pleaded, there is no case which the Court can consider and also later on he characterised the majority approach on the matter as "salami-slicing" and also 'an unreal, artificial, highly constricted – and yet unduly unconstrained – process'.

96 Schloemann and Ohlhoff (n 2) 439.

Panels have jurisdiction over claims dealing with the interpretation of Article XXI as with any other matter within the scope of the WTO Agreements.[97] Indeed, the DSU is an Annex to the WTO Agreement and, as such, legally separate from the GATT. Furthermore, DSU Article 11 directs panels to 'make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements'.[98] This Article seems to provide Panels and the AB with some leeway in exercising jurisdiction over disputes that are not exclusively about trade although, arguably, they ought to afford a certain degree of deference in their judgments when the political stakes are high.[99] Moreover, Lindsay has made an *a contrario* argument against a fully self-judging Security Exception.[100] He suggests that DSU Article 22.3(c) contains similar self-judging language when regulating the Members' response to an unremedied violation since it provides that if the 'party *considers* that it is not practicable or effective to suspend concessions… under another covered agreement'.[101] When the issue arose in one of the *EC – Bananas* cases, Ecuador argued that its decision to suspend concessions under the TRIPS as a retaliatory measure against EC's failure to implement a previous ruling was insulated from any substantive review by the arbitrators.[102] The arbitrators, however, refuted this argument and claimed that despite the fact that the language of the provision 'leaves a certain margin of appreciation to the complaining party', that margin 'is subject to review by

97 Akande and Williams (n 90) 380.

98 See Thomas Schoenbaum, 'WTO Dispute Settlement: Praise and Suggestions for Reform' (1998) 47 International and Comparative Law Quarterly 647 who even goes as far as suggesting that Article 11 is an 'implied powers clause' which 'should be interpreted broadly so that the panels and the Appellate Body can decide all aspects of a dispute'.

99 For instance, it has even been suggested that in extreme cases a WTO Panel could proclaim that it does not consider it 'appropriate to exercise its jurisdiction', William J Davey, 'Has the WTO Dispute Settlement System Exceeded its Authority? A Consideration of Deference shown by the System to Member Government Decisions and its Use of Issue-avoidance Techniques' (2001) 4 Journal of International Economic Law 79, 95.

100 Lindsay n (31) 1288 *et seq*.

101 Article 22.3(c), Dispute Settlement Rules: Understanding on Rules and Procedures Governing the Settlement of Disputes, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations 354 (1999), 1869 UNTS 401, 33 ILM 1226 (1994).

102 *EC – Bananas III (Ecuador) (Article 22.6 – EC)* Decision by the Arbitrators, European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 226 of the DSU, WT/DS27/ARB/ECU, 24 March 2000, DSR 2000:V, 2237 [22].

arbitrators'.[103] The way the arbitrators dealt with this matter might give us a hint about how they might approach an interpretation of the security exception in the future although arguably the context of these two provisions is quite different.[104]

In any case, as was evidenced by an analysis of the relevant State Practice, in the nearly 50 years of GATT's existence, the issue arose in more than one instance. Since the Member States were well aware of the ambiguity of Article XXI, they could have amended the Agreement at the conclusion of the Uruguay Round so as to insulate their decisions from any scrutiny, judicial or political, in the context of the WTO. Given that the main reform that was brought by the WTO Agreements was the 'judicialization' of the system, it is very peculiar that the States neglected to clarify any hypothetical completely unreviewable exception. The absence of such an express exception to jurisdiction coupled with the 'strengthening of the multilateral system' could be perceived as evidence that the Parties intended the National Security Exception to be subject to dispute settlement under the WTO.[105]

Perhaps more importantly from a normative point of view, should this interpretation be taken to its logical conclusion, a Member could invariably circumvent its WTO obligations by simply invoking national security concerns.[106] Even the acceptance or the

103 ibid [27].

104 See Lindsay (n 31) 1290 who mitigates the aforementioned argument by pointing out this interpretation could be partly attributed to the mandatory language of the chapeau of Article 22.3 ('the complaining Parties *shall* apply the following principles and procedures') and the fact that the self-defining language is qualified by language stating that the party may '*seek* to suspend concessions' (indicating that it might be unable to do so in some instances).

105 Stephan W Schill and Robyn Briese, '"If the State Considers": Self-Judging Cluases in International Dispute Settlement' in Armin Von Bogdandy and Rüdiger Wolfrum (eds), *Max Planck Yearbook of United Nations Law*, vol 13 (2009) 61–140, 105; *Cf* Mitsuo Matsushita, Thomas J Schoenbaum and Petros C Mavroidis (eds), *The World Trade Organization: Law, Practice and Policy*, vol 127 (2nd edn, Oxford University Press 2006) 594–598; see also *Sempra v Argentina (Award)* [366]–[368] in which an investment arbitral tribunal, in an *obiter dictum*, made the same point about the GATT:

> The Tribunal must also note that not even in the context of GATT Article XXI is the issue considered to be settled in favor of a self-judging interpretation, and the very fact that such article has not been excluded from dispute settlement is indicative of its non-self- judging nature.

106 For an argument by analogy see *US – Import Prohibition of Certain Shrimp and Shrimp Products* WTO Appellate Body, WT/DS58/AB/R, adopted 6 November 1998, DSR 1998:VII, 2755 US – Shrimp (AB) [156] where the Appellate Body when interpreting the chapeau of Article XX GATT noted:

> To permit one Member to abuse or misuse its right to invoke an exception would be effectively to allow that Member to degrade its own treaty obligations as well as to devalue the treaty rights of other Members. If the abuse or misuse is sufficiently grave or extensive, the Member, in effect,

perception of acceptance of such a possibility is not consistent[107] with a rules-based system that ensures 'stability and predictability in the international trade order',[108] the main rationale underlying the creation of the WTO.

Indeed, it could even be suggested that a legal obligation that is self-judging is not a legal obligation at all. Judge Sir Hersch Lauterpacht argued this point – also adopted by others[109] – eloquently in the *Norwegian Loans* case (in the context of declaring upon the validity of a self-judging acceptance of the jurisdiction of the Court):

> An instrument in which a party is entitled to determine the existence of its obligation is not a valid and enforceable legal instrument of which a court of law can take cognizance. It is not a legal instrument, it is a declaration of a political principle and purpose.[110]

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> reduces its treaty obligation to a merely facultative one and dissolves its juridical character, and, in so doing, negates altogether the treaty rights of other Members.

107 Cottier and Delimatsis (n 10) 332.

108 Schloemann and Ohlhoff (n 2) 425; see also Wesley A Cann, 'Creating Standards and Accountability for the Use of the WTO Security Exception: Reducing the Role of Power-Based Relations and Establishing a New Balance Between Sovereignty and Multilateralism' (2001) 26 Yale Journal of international Law 413, 436–439 arguing that the multilateralism embodied in the WTO is inconsistent with '[t]he unilateral imposition of security-based sanctions, based upon a self-defining and fluid security exception'; Todd C Piczak, 'The Helms-Burton Act: US Foreign Policy Toward Cuba, the National Security Exception to the Gatt and the Political Question Doctrine' (1999) 61 University of Pittsburgh Law Review 287, 310–311 who argues that the 'new legalism' of the WTO DS system would empower a WTO Panel to proceed in examining an Article XXI claim on its merits; *contra* Akande and Williams (n 90) 378 who claim that 'the WTO dispute settlement system is only competent to the extent the WTO Agreements allocate competence to the system'.

109 See Judge J Guerro (dissenting), *Certain Norwegian Loans (France v Norway)* [1957] ICJ Rep 9, 69 stating that:

> [S]uch reservations must be regarded as devoid of all legal validity. It has rightly been said that it is not possible to establish a system of law if each State reserves to itself the power to decide itself what law is.

See also generally Stanimir A Alexandrov, *Reservations in Unilateral Declarations Accepting the Compulsory Jurisdiction of the International Court of Justice*, vol 19 (Martinus Nijhoff Publishers 1995).

110 Separate Opinion of Judge Sir Hersch Lauterpacht, *Norwegian Loans case* (n 109) 48; he also pointed out that the ineffectiveness of self-judging or unilaterally determined obligations is a general principle of law already recognised in domestic contract law; see also Dissenting Opinion of Judge Sir Hersch Lauterpacht, *Interhandel (Switzerland v United States)* (Preliminary Objections) [1959] ICJ Rep 6, 99–102 where he concluded that the reservation invalidated the entire US submission to the Court's compulsory jurisdiction, and that:

> Accordingly, there being before the Court cannot act upon it in any way even to the extent of examining objections to admissibility and jurisdiction other than that exercised in the automatic reservation.

Consequently, to construct Article XXI as entirely self-judging would be equal to entitling a Member State to unilaterally determine when it is obliged to comply with the GATT. Such an interpretation would, as Judge Lauterpacht observed, render the legal obligation null and void.[111] We should, however, note that this pronouncement was made in relation to a unilateral declaration of a State and not a provision of a multilateral agreement and, thus, its logic could not be extended automatically to the issue at stake.[112]

Nevertheless, to construct Article XXI GATT as well as Article XIV$^{bis}$ GATS as entirely self-judging would be an unsound proposition both legally and normatively.

A variation on the aforementioned fully 'self-judging' nature of this exception is the view that, despite the fact that the Panels maintain their jurisdiction, these disputes are fundamentally non-justiciable.[113] The rationale underlying this doctrine is that some disputes are of a highly political nature and, as such, courts and tribunals ought not to adjudicate upon them. This theory constitutes a direct analogy to the 'political questions' or other non-justiciability doctrines that can be found in several domestic legal systems.[114] Indeed, in many domestic legal systems, the judiciary will not address these 'political questions' and will instead refer them to the State's executive or legislative authorities. According to an application of this doctrine in this setting, Panels ought to defer to the State's exclusive interpretative authority of the national security exception[115] and declare such claims as inadmissible.

111 Akande and Williams (n 90) 384.

112 Schill and Briese (n 105) 61–140, 89.

113 For a very detailed history of the inception and development of the doctrine in International Law see Hersch Lauterpacht, 'The Doctrine of Non-Justiciable Disputes in International Law' (1928) 24 Economica 277; for more on this concept see H Lauterpacht, *The Function of Law in the International Community* (The Clarendon press 1933) 6–48; Thomas J Bodie, *Politics and the Emergence of an Activist International Court of Justice* (Greenwood Publishing Group 1995); Ian Brownlie, 'The Justiciability of Disputes and Issues in International Relations' (1967) 42 British Yearbook of International Law 123.

114 For more on this doctrine in a domestic law context see Thomas M Franck, *Political Questions Judicial Answers: Does the Rule of Law Apply to Foreign Affairs?* (Princeton University Press 2012); Nada Mourtada-Sabbah and Bruce E Cain, *The Political Question Doctrine and the Supreme Court of the United States* (Lexington Books 2007); Mark Tushnet, 'Law and Prudence in the Law of Justiciability: the Transformation and Disappearance of the Political Question Doctrine' (2001) 80 North Carolina Law Review 1203; however for a critique of the doctrine even in a domestic law context see Chris Finn, 'The Justiciability of Administrative Decisions: A Redundant Concept?' (2002) 30 Federal Law Review 239.

115 See, eg, Whitt (n 93) 616.

This argument, however, is largely misplaced. First of all, as Sir Hersch Lauterpacht concluded more than 70 years ago, at a time when the international legal order was much less developed and sophisticated than what it is now:

> The division of conflicts between states into justiciable and non-justiciable differences is, when purported to be grounded in the intrinsic nature of international relations, formally untenable and legally unsound.[116]

Last but not least, the argument that national security questions are essentially political questions and, hence, non-justiciable has been made in a multitude of international courts and tribunals, only to fail time and time again.[117]

Therefore, we can conclude that the theory of 'non-justiciable' international disputes has never gained any substantial support or attained the status of an accepted legal doctrine and, thus, its invocation in this context should not be accepted.

*(ii) The Appropriate Standard of Deference under Article XIV^bis^*

Having concluded that the invocation of the Security Exception by a Member State is not sufficient to devoid the Panels of their jurisdiction or to render a dispute non-justiciable, what remains to be determined is how the competent Panels should review the invocation of Article XIV$^{bis}$; namely, what is the appropriate standard of deference when reviewing such a decision. Several scholars have dealt with this issue and they seem to gravitate in between two interpretive 'poles'. Some of them suggest that the Panels ought to be very deferential towards the invocation of the exception by a State and only review the very outer limits of this decision, namely its compliance with the principle of good faith. Others suggest that the specifically enumerated conditions under which the exception can be invoked form 'an objective core' and ought to be independently assessed by the adjudicators. The answer to these questions is crucial since each of them implies a different degree of deference that could affect the lawfulness of foreign investment screening mechanisms under the GATS.

116 Lauterpacht (n 113) 315.

117 See Akande and Williams (n 90) 382–383.

#### (a) ‘Good faith’ as the sole limit

According to one line of thinking, a State would still be able to independently decide whether the security exception as a whole would be applicable but that judgment would have to at least conform to a ‘good faith’ standard that is subject to adjudication.[118] Cottier and Delimatsis, for instance, have argued that ‘acting in accordance with the principle of good faith is a significant concept in cases involving the invocation of an exception.’[119]

Others have similarly argued that despite the existence of a ‘subjective element’, necessity by definition implies proportionality and, thus, the measure must be proportionate to the causing action, even if the degree of manoeuvre offered to the Member State is significant.[120] Under this analysis, only the most important of the security interests ought to be protected by the exception and the measure should be ‘credible’[121] as to their protection, the limit being abuse of rights.[122]

Indeed, the principle of good faith seems to have a wide application even attaining the status of a general principle of international law[123] and a general principle of law and, as a consequence, it should inform the interpretation of the totality of WTO Law.[124] Furthermore, such an interpretation could also be justified under the ‘*abus de droit*’[125]

118 See *inter alia* ibid, 390; William W Burke-White and Andreas Von Staden, ‘Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties’ (2007) 48 Virginia Journal of International Law 307, 377–378.

119 Cottier and Delimatsis (n 10) 333.

120 Hahn (n 94) 603; George-Dian Balan, ‘The Latest United States Sanctions Against Iran: What Role to the WTO Security Exceptions?’ (2013) 18 Journal of Conflict and Security Law 365, 388.

121 Balan (n 120) 389.

122 Bhala (n 43) 263; Balan (n 120) 389.

123 See generally Bin Cheng, *General Principles of Law as Applied by International Courts and Tribunals*, vol 2 (Cambridge University Press 1994); Gerald Fitzmaurice, ‘The Law and Procedure of the International Court of Justice, 1951-54: General Principles and Sources of Law’ (1953) 30 British Yearbook of International Law 1, 53.

124 *US – Shrimp (AB)* (n 106) [158]; *US – Tax Treatment for “Foreign Sales Corporations”* WTO Appellate Body, WT/DS108/AB/R, adopted 20 March 2000, DSR 2000:III, 1619 [166]; *United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan* Appellate Body Report, WT/DS184/AB/R, adopted 23 August 2001, DSR 2001:X, 4697 [101].

125 See Robert Yewdall Jennings and Sir Arthur Watts (eds), *Oppenheim’s International Law* (Longman Harlow 1992) 407–410; John F O’Connor, *Good Faith in International Law* (Dartmouth 1991).

doctrine of international law, according to which a State may not misuse its right by taking actions for purposes that go beyond the purpose for which the right exists.[126]

The invocation of such a general principle could be justified under the text of DSU and the case law of the WTO AB[127] and, in fact, the AB has held that the doctrine of abuse of rights is an application of the general principle of good faith.[128] Even the qualification of the judgment of the Member State by such a principle, however, could not go as far as introducing a reasonableness or necessity test;[129] indeed, what ought to be precluded here is a deliberate misuse of the right conferred upon the State by Article XXI.[130] As the Appellate Body in *US—Anti-Dumping and Countervailing Duties (China)* explained, one meaning of good faith interpretation is that 'terms of a treaty are not to be interpreted based on the assumption that one party is seeking to evade its obligations and will exercise its rights so as to cause injury to the other party'.[131]

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126 For a first articulation of the principle of '*abus de droit*' in international law see *Free Zones of Upper Savoy and the District of Gex (France v Switzerland)* Judgment of 7 June 1932, [1932] PCIJ (Ser A/B) No 46 PCIJ, 167 where the Court, whilst recognising that France has a sovereign right to establish a police cordon at the political frontier, for the control of traffic and even the imposition of fiscal taxes, it further proclaimed that:

> A reservation must be made as regards the cases of abuses of process ['les cas de l'abus de droit'], since it is certain that France must not evade the obligation to maintain the zones by erecting a customs barrier under the guise of a control cordon.

127 See Article 3(2) DSU which provides that the DS system of the WTO serves to 'clarify the existing provisions of those [the WTO] agreements in accordance with customary rules of interpretation of public international law'; see also *US – Gasoline* Appellate Body Report, United States – Standards for Reformulated and Conventional Gasoline, WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:I, 3, 17 where the AB stated that the WTO Agreements are 'not to be read in clinical isolation from public international law'; for the relationship between general rules of public international law and WTO law see David Palmeter and Petros C Mavroidis, 'The WTO Legal System: Sources of Law' (1998) 92 American Journal of International Law 398.

128 *US – Shrimp (AB)* (n 106) [158].

129 See P Craig, 'Judicial Review, Intensity and Deference in EU Law' in David Dyzenhaus (ed), *The Unity of Public Law* (Hart Publishing, Oxford 2004) 340–344 who argues that the ECJ, for instance, has developed a variable test which is substantially equivalent to rational scrutiny. Under such a test, even European Courts are more deferential where an individual challenges a policy choice by the administration, especially in issues of economic or social policy. *A minore ad maius*, if such a standard applies in a quasi-federal structure such as the EU, it would be absurd to employ it in the context of the GATS.

130 Akande and Williams (n 90) 392; see also Cheng (n 123) 121 *et seq*. who argues that good faith prevents the malicious, fictitious or dishonest exercise of legal rights.

131 *US – Anti-Dumping and Countervailing Duties (China)* Appellate Body Report, United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China, WT/DS379/AB/R, adopted 25 March 2011 [326] (emphasis added).

Last but not least, as evidenced earlier, it has been argued that such an interpretation would be more in line with the original intentions of some of the Treaty drafters[132] who were concerned that the exception is so broad that, under the guise of security, countries will enact measures which really have a 'commercial purpose'.[133]

Indeed, if we accept that Article XIV$^{bis}$ could excuse restrictions on the basis of perceived potential non-military threats (ie, economic) then this only leads to a slippery slope. In the past, an attempt has been made to link national security and competitiveness of certain so-called 'national' or 'key' industries. An example of an explicit formulation of this argument can be found during the debates preceding the passage of the US Omnibus Trade and Competitiveness Act of 1998 when several members of the Congress identified a link between National Security and the viability of certain national industries.[134] Indeed, one author even asked the question whether the essential security interests of Article XXI cover the interests of the States to maintain the viability of important industries and/or save natural wealth for future generations.[135] It should be accepted, however, that these exceptions were not designed to cover these types of situations; what was rather envisaged were situations 'outside the regular scope of the GATT'[136] and not a 'commercial escape clause'[137] to deal with the negative socioeconomic consequences resulting from the operation of GATT principles.[138] If such

132 Akande and Williams (n 90) 390.

133 See GATT, Analytical Index: Guide to GATT Law and Practice (n 32) 20–21 whereby one of the drafters of the original draft noted that 'there was a great danger of having too wide an exception […] that would permit anything under the sun' but that a provision was necessary to protect 'real security interests' and that in attempting to balance these competing interests '[w]e cannot make it so broad that, under the guise of security, countries will put on measures which really have a commercial purpose'.

134 See, eg, the so-called Gephardt amendment, United States Congress, House of Representatives, *Omnibus Trade and Competitiveness Act, 100th Congress, HR 3, 1st Session, 133 Congress Record, H2642, 10* (1987), 375–484; see also statements of Senator R Byrd before the Senate Finance Committee, United States Congress, Senate Finance Committee, *Impact of Imports and Foreign Investments on National Security: Hearing Before the Senate Committee on Finance, 100th Congress, 1st Session* (1987), 36–37, 43, 50–52; see also United States Congress, Senate Finance Committee, *Threat of Certain Imports to National Security: Hearing Before the Senate Committee on Finance, 99th Congress, 2d Session* (1986), 32–44.

135 Hahn (n 94) 580 *et seq*.

136 ibid 580 *et seq*.

137 Delegate for the United States in a reply to the Delegate for the Netherlands, Economic & Social Council United Nations, *Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment*, UN Doc E/PC/T/A/SR/33 (24 July 1947) 3.

138 Hahn (n 94) 580

an approach were to be adopted then, arguably, the US automobile industry should have been perceived as of an essential character and Japanese imports should have been restricted in order to protect it.

It is highly doubtful that a 'good faith' interpretation of the provision would cover such factual situations. As succinctly put by Akande and Williams:

> [A] good faith test means that the member invoking Article XXI(b) must genuinely—"or in fact" or subjectively—consider that there is some threat to its security interests which needs protecting. A panel may therefore seek to ensure that the State is not using Article XXI as a cloak for taking protectionist action or for pursuing other aims . . . This level can be derived, firstly, from the terms of Article XXI(a) and (b) itself […].[139]

Therefore, the view that measures enacted by Member States and serve a Member's essential security interest in conjunction with other (even commercial) interests, fall within the ambit of the security exceptions[140] ought not be accepted since it would constitute a 'bad faith' invocation.

This is exactly what makes the operation of foreign investment screening mechanisms highly problematic. Their institutional design allows host States to block incoming investment in the field of services on the basis of a very widely conceived notion of 'security' that conflates security and non-security interests. Even if that is not explicitly provided for in their mandate − which it usually is − practice has proven that very often commercial or other political considerations infiltrate these decisions. This is particularly true for SWFs and, it is submitted, ought to be an unjustified behaviour under the GATS. Indeed, most foreign investment screening mechanisms, as they stand, are to varying degrees in violation Article XIV$^{bis}$ GATS.

Obviously, in the absence of a 'smoking gun', proving that a measure was enacted in bad faith is very difficult—given that motive has to be proven.[141] Nonetheless, this is an evidentiary matter that should not detract anything from the rule.[142] As the Wikileaks scandal has proven, access to information, even of a highly classified nature, is

[139] Akande and Williams (n 90) 389–390.

[140] Cottier and Delimatsis (n 10) 335.

[141] Schloemann and Ohlhoff (n 2) 445 claiming that such a feat is 'next to impossible in practice'.

[142] Indeed, reference to Parliamentary debates or Statements made by officials may be enough to demonstrate that the motivation behind enacting a certain measure was commercial or, in any case, having nothing to do with national security concerns.

becoming more and more common.[143] In any case, it has to be acknowledged that, in practice, it would be difficult to prove such bad faith invocation of national security concerns by foreign investment screening mechanisms. Nonetheless, the normative strength of the argument remains; the concerns regarding the operation of SWFs are usually not of a strict national security nature and, as such, should not be dealt with under the national security exception.

(b) An 'objective core' as an additional limit

At the other end of the spectrum we encounter an interpretation that would further restrict the discretion of the Member States when invoking the national security exception. According to it, a State would only enjoy a wide margin of discretion when deciding whether a certain measure is 'necessary for the protection of its essential security interests'. Conversely, the argument goes, the phrase 'it considers' does not inform the rest of the provision, thus limiting the State's discretion in invoking the exception—unless one of the explicitly enumerated conditions is engaged. Under this interpretation, the conditions in the subparagraphs form an objective standard and a panel ought to be competent to assess whether or not these conditions are fulfilled;[144] an approach akin to a full judicial review.[145] Even in this case, however, once the objective condition is met, the WTO scrutiny will be limited to measures that are 'manifestly unnecessary or disproportionate to the threat'[146] thus also conforming to the 'good faith' limit described earlier.

An argument in support of such an interpretation is based on the principle of '*exception est strictissimae interpretationis',* a general principle of law – or at least international law − according to which exceptions ought to be narrowly interpreted. This principle has been endorsed by the CJEU[147] but has failed to attain universal recognition at the

[143] For a discussion on the admissibility of WikiLeaks cables as evidence in ICSID arbitrations see Jessica O Ireton, 'The Admissibility of Evidence in ICSID Arbitration: Considering the Validity of WikiLeaks Cables as Evidence' (2014) 30 ICSID Review.

[144] Hahn (n 94) 584–591; Schloemann and Ohlhoff (n 2) 445; Akande and Williams (n 90) 399–400; Balan (n 120) 388.

[145] Cottier and Delimatsis (n 10) 340; Akande and Williams (n 90) 399.

[146] Cottier and Delimatsis (n 10) 345.

[147] See Case C-414/97 *The Commission v Spain* [1999] ECR I–05585 [21]; Case C-61/05 *The Commission v Denmark* [2009] ECR I–11887 [52] and the case-law quoted therein.

international plane. The WTO case law seems to be unsettled – to the very least – on the matter. There have been reports where the Panels seem to recognise the relevance of such a principle.[148] Recently, however, the WTO AB seems to have rejected the application of this principle in WTO law when it stated that:

> [M]erely characterizing a treaty provision as an "exception" does not by itself justify a "stricter" or "narrower" interpretation of that provision that what would be warranted by examination of the ordinary meaning of the actual words, viewed in context and in the light of the treaty's object and purpose, or, in other words, by applying the normal rules of treaty interpretation.[149]

Indeed, this latter approach is more reasonable given the fact that the VCLT binds the WTO DS Bodies to take into account the context in which that principle has emerged; in this case, domestic legal systems when dealing with the balancing between rights and obligations of individuals in a constitutional setting.

Furthermore, it has been suggested that such an interpretation would seem to conform best with the intention of the drafters as well as the principle of '*effet utile*'.[150] Arguably, if the Exception were to be self-judging to such a significant degree, the explicit mention of further conditions would be superfluous.

If we subscribe to the view that constructs the specifically enumerated conditions of the GATS national security exception as 'objective' preconditions for its invocation, then the existence of foreign investment screening mechanisms, especially when it comes to SWFs, becomes legally questionable.

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148 See *Japan – Agricultural Products I* GATT Panel Report, Japan – Restrictions on Imports of Certain Agricultural Products, L/6253, adopted 2 March 1988, BISD 35S/163 [5.1.3.7]; *EEC – Apples (US)* GATT Panel Report, European Economic Community – Restrictions on Imports of Apples – Complaint by the United States, L/6513, adopted 22 June 1989, BISD 36S/135 [5.3]; *Canada – FIRA* GATT Panel Report, Canada – Administration of the Foreign Investment Review Act, L/5504, adopted 7 February 1984, BISD 30S/140, 164.

149 *China – Publications and Audiovisual Products* Appellate Body Report, WT/DS363/AB/R, adopted 19 January 2010, DSR 2010:I, 3 [233].

150 See Schloemann and Ohlhoff (n 2) 431, ft 38; see especially *United States – Gasoline (AB)* (n 127) 23 which noted that '[o]ne of the corollaries of the 'general rule of interpretation' in the Vienna Convention is that interpretation must give meaning and effect to all the terms of the treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility'; see also *Japan – Alcoholic Beverages II* WTO Appellate Body, Japan – Taxes on Alcoholic Beverages, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97, 10–11 which reaffirmed that '[a] fundamental tenet of treaty interpretation flowing from the general rule of interpretation set out in Article 31 is the principle of effectiveness (*ut res magis valeat quam pereat*)' (emphasis added).

Arguably, Member States would attempt to argue that the operation of these mechanisms is justified under the third subparagraph of Article XIV$^{bis}$, which exempts state action taken in a time of emergency in international relations. This, however, is the most controversial aspect of Article XIV$^{bis}$ since it is the provision that is potentially open to the most abuse and the one that in practice has been invoked the most often.[151] Indeed, if a dispute involving a SWF actually ever arises under the GATS, it is nearly certain that the respondent State will attempt to justify any potential violation of the substantive provisions under this subparagraph. States would be inclined to claim that there is some sort of 'other emergency in international relations', a *prima facie* open ended concept, if they have to justify the maintenance of a measure under the exception.

In that context, it has been argued that this determination is of a very sensitive nature and, thus, not capable of being reviewed by an international judicial body[152] despite the fact that there is case law supporting such a proposition.[153] If, however, we subscribe to the view that perceives the invocation of these conditions as reviewable, then the text of the provision could offer some guidance as to its interpretation, irrespective of how deferential the Panel ought to be when reviewing the decision of the State. Indeed, a more careful reading of the provision reveals its limits. The word 'other' indicates that the emergency situation has to be of similar *gravitas* as the 'time of war'.[154] If 'other emergency' were to be interpreted as a term that covers all situations in which a State perceives as threatening, then the provision would be stripped of any prescriptive content.[155] Evidently, the wording reveals that a threat should be imminent and that the situation justifying the measure ought to be have arisen 'suddenly and recently'.[156] Therefore, measures taken years after the 'emergency' situation arose could

151 Akande and Williams (n 90) 400.

152 Hahn (n 94) 587; Piczak (n 108) 318–326.

153 For decisions of some other international tribunals that have actually assessed the existence of war see *Prosecutor v Tadic* Case IT-94-I-AR72, 35 ILM 32 International Criminal Tribunal for the former Yugoslavia, 488; see also *Denmark, Norway, Sweden & The Netherlands v Greece* Yearbook of the European Convention on Human Rights 1969/II European Commission of Human Rights Report 71–76 for an instance where an international tribunal not only assessed the determination of a State about the existence of an 'emergency' situation but also went as far striking that determination down.

154 Schloemann and Ohlhoff (n 2) 446.

155 ibid 447.

156 Cottier and Delimatsis (n 10) 344.

not be possibly justified under the national security exception. It has also been suggested that Member States should have the ability to take preventive action to the extent that this is not an abusive exercise of their rights.[157] Even if this were to be conceded though, mere speculation about a possible deterioration of international relations would not conform to this standard.

In that context, if we accept that there exists an 'objective limit' in the invocation of the national security exception under the GATS, then it becomes almost impossible to justify the existence of foreign investment screening mechanisms with the competence to block SWFs' investments in the field of services and, even more, order them to disinvest. Indeed, the current practice of States so far and their use of foreign investment screening mechanisms are clearly abusive. For instance, the blocking of the Dubai Ports acquisition by CFIUS would be very difficult to justify under these provisions since there was not a security emergency situation between the US and Dubai at the time and, in fact, Dubai is a long-term ally and partner of the US even having signed a bilateral agreement for nuclear co-operation.[158]

*(iii) Foreign Investment Screening Mechanisms as Nullification and Impairment of Benefits*

In addition to the disputed legality of foreign investment screening mechanisms under Article XIV$^{bis}$ of the GATS, their operation could be also disputed under Article XXII of the GATS.

The aforementioned provision provides that, in certain instances, Member States can claim that a measure imposed by another State is nullifying or impairing an expected trade benefit under the relevant WTO Agreement.[159] This nullification or impairment is

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157 Bhala (n 43) 263; Cottier and Delimatsis (n 10) 340.

158 See, eg, the Agreement for Cooperation Between the Government of the United States and Government of the United Arab Emirates Concerning Peaceful Uses of Nuclear Energy.

159 Article XXIII, GATT:

> If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as the result of […] (b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement… the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers to be concerned.

linked to the notion of 'reasonable expectations'[160] and, as Hoekman and Mavroidis have noted, reasonable expectations are created by way of concessions that are negotiated at any given point in time and contracting parties can reasonably expect that the balance of these concessions will not be later nullified or impaired.[161]

This is a rather peculiar provision since it establishes the liability of a Member State for conduct that is not explicitly defined in the Agreement itself, provided it offsets or modifies the aforementioned agreed-upon concessions. The idea behind this provision is that the 'improved competitive opportunities that can legitimately be expected from a tariff concession can be frustrated not only by measures proscribed by the General Agreement but also by measures consistent with that Agreement.'[162]

Interestingly, it seems that the possibility that this provision could apply to measures justified under the national security exception had already been envisaged and accepted at the drafting stage of the Agreement.[163] It has also been argued that an examination of the 'reasonable expectations' aspect of the test necessitates an examination of the

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[160] See Minutes of Meeting held on 5 November 1986, GATT Doc. C/M1204 (19 November 1986) 9.

[161] Bernard M Hoekman and Petros C Mavroidis, 'Competition, competition policy and the GATT' (1994) 17 The World Economy 121, 122–125; see also *US – Trade Measures Affecting Nicaragua* (n 56) [4.8] where it is stated that nullification or impairment is linked to activity 'that could not reasonably have been anticipated at the time when the […] concessions were negotiated'.

[162] *EC – Asbestos* Appellate Body Report, European Communities – Measures Affecting Asbestos and Asbestos-Containing Products, WT/DS135/AB/R, adopted 5 April 2001, DSR 2001:VII, 3243 [185]; see also *Japan – Film* Panel Report, Japan – Measures Affecting Consumer Photographic Film and Paper, WT/DS44/R, adopted 22 April 1998, DSR 1998:IV, 1179 [10.79]–[10.80]; *EEC – Oilseeds I* GATT Panel Report, European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal- Feed Proteins, L/6627, adopted 25 January 1990, BISD 37S/86 [144]–[146]; *Germany – Sardines* GATT Panel Report, Treatment by Germany of Imports of Sardines, G/26, adopted 31 October 1952, BISD 1S/53 [16]; *Australia – Ammonium Sulphate* Working Party Report, The Australian Subsidy on Ammonium Sulphate, GATT/CP4/39, adopted 3 April 1950, BISD II/188 [12].

[163] Cherie O'Neal Taylor, 'Impossible Cases: Lessons from the First Decade of WTO Dispute Settlement' (2007) 28 University of Pennsylvania Journal of International Economic Law 309, 389; see also Conference on Trade and Development, Report of Working Party of Sub-Committee G of Committee VI on Chapter VIII, E/Conf.2/C.6/W.30 (9 January 1948) where a member of this drafting committee stated:

> The Working party considered that this sub-paragraph [the non-nullification or impairment remedy] would apply to the situation of action taken by a Member… pursuant to [Article XXI of GATT 1947]. Such action, for example, in the interest of national security in time of war or other international emergency would be entirely consistent with the Charter, but might nevertheless result in the nullification or impairment of benefits accruing to other Members. Such other Members could, under those circumstances, have the right to bring the matter before the Organization, not on the ground that the measure taken was inconsistent with the Charter, but on the ground that the measure so taken effectively nullified benefits accruing to the complaining Member.

appropriateness of the measure in question and that would contravene the very purpose of Article XXI, which is to exempt the Contracting Parties from such scrutiny.[164]

In any case however, the AB has stated that this remedy is 'exceptional' and that it should be 'approached with caution'[165] thus severely limiting the instances where recourse to it can be made. In fact, the invocation of this remedy has only been successful once.[166] In addition, meeting the standard of proof for this remedy is reasonably hard since it requires the complaining Member to prove that the trade restriction 'could [not] reasonably have been anticipated'[167] at the time of the negotiations. Even with this high standard, however, this provision could have a role to play in preventing Member States from abusing the WTO national security exceptions. Admittedly, based on the aforementioned state practice, this remedy could not have possibly been invoked in the cases of the US boycott of Cuba or the Marshall Plan; nevertheless, it could have an appropriate application in instances like Saudi Arabia's secondary boycott of Israel; arguably the expectations Saudi Arabia had generated with its behaviour up until its accession were frustrated. Interestingly enough, one of the claims of the EC in the 'Libertad controversy' was that the US measures nullified or impaired reasonably expected benefits under GATT 1994 and GATS and impeded the attainment of the objectives of GATT 1994.[168]

In the case of SWFs, it could be argued that at least the EU and the US did generate expectations that they would liberalise their services markets though the GATS, despite the fact that they were aware of the existence of SWFs and other similar State-owned enterprises when they were negotiating the Treaty. Furthermore, when in the aftermath of the 2008 financial crisis they welcomed investment in their financial system by several SWFs, they further reinforced these expectations. Therefore, deciding to block SWFs investments on an *ad hoc* basis and contingently upon the political climate of the time – and then justifying it on the basis of the national security exception – would be

[164] Hahn (n 94) 617.

[165] *EC – Asbestos (AB)* (n 162) [186].

[166] *EC – Asbestos* Panel Report, European Communities – Measures Affecting Asbestos and Asbestos-Containing Products, WT/DS135/R and Add1, adopted 5 April 2001, as modified by Appellate Body Report WT/DS135/AB/R, DSR 2001:VIII, 3305 [8.289]; *Japan – Film* (n 162) [10.61].

[167] Hoekman and Mavroidis (n 161) 122–125.

[168] *US – The Cuban Liberty and Democratic Solidarity Act* Request for the Establishment of a Panel by the European Communities, GATT Doc WT/DS38/2/Corr1, 14 October 1996.

inconsistent and frustrating of previously generated expectations. This is exactly a situation where a reasonably anticipated benefit is being impaired, especially if this happens in times of peace (as has always been the case with most of home States of SWFs). Therefore, it is submitted that a bad faith invocation of the national security exception that could have not been reasonably anticipated ought to give rise to a successful non-violation claim.[169] More importantly, the *ad hoc* blocking of SWFs investments' in the field of services – even if justified under a self-judging security exception – would warrant the award of such a remedy.

Nonetheless, it has to be admitted that the lack of information on the motives of the host State would render the invocation of this provision quite difficult—at least as a matter of fact. Indeed, in such a situation, errors could prove to be very costly and no panel members would be willing to assume such risks light-heartedly.

## C. NATIONAL SECURITY EXCEPTIONS IN INTERNATIONAL INVESTMENT LAW

### 1. Introduction

As we explained earlier, there are various schemes and mechanisms that allow host States to intervene at the pre-establishment stage of an incoming investment in order to block (or even order already established investors to divest)—the usual justification for these being the presence of a perceived national security threat. Most often, the chosen mechanism is a foreign investment screening committee, which usually has a very wide mandate, uses the term national security very liberally and – at least presumably – enjoys a largely unfettered discretion in its decisions.

Preliminarily, the distinction between BITs that cover only the post-establishment stage of an investment and the ones that extend their scope to pre-establishment as well needs to be kept in mind. Countries that have concluded BITs of the former type maintain full flexibility in imposing any restrictions they see fit upon incoming foreign investors and in any sectors of their economy. Even these countries, however, would be in principle prohibited from taking measures against already established investors. Nevertheless, it is not entirely without precedent that a host State would order an investor to divest due to the fact that the relevant economic sector became security-

169 Alford (n 8) 749.

relevant or because it attained a certain strategic importance.[170] In addition, foreign relations with another country could suddenly deteriorate with deleterious effects on the economic relations in general, and on established foreign investments in particular. In these cases, a national security exception can be engaged and any such measure would need to be justified under it—lest the host State compensate the investor.

When it comes to the IIAs that this thesis focuses on – the ones covering the pre-establishment stage – national security considerations take a first seat. These agreements constitute the minority of BITs in force now, but there seems to be a definite trend in their favour—for instance, most of the FTAs with investment chapters that are being negotiated right now (or have already been concluded) do cover the pre-establishment stage.[171] In these treaties, foreign investors are being granted MFN and NT treatment and, as we explained, any rejection of their investments by the host State on national security grounds would *prima facie* amount to a violation of the non-discrimination standard.

On the other hand, and partly as a response to the growing trend of BITs that cover the pre-establishment stage, some host States tend to favour a broad concept of National Security. Such a conceptualisation accords the government with increased discretion in designating strategic sectors and, as such, the ability to restrict the flow of investment in the sectors it sees fit. The rationale behind these restrictions is a fear that foreigners might misuse their control or influence over vital parts of the economy (eg, transportations, telecommunications, energy or water) in a hostile manner. Furthermore, there is rising concern about SWFs, and the possibility that the assets they have acquired could be used to further political goals and influence domestic affairs. For these reasons, many of the agreements contain carve-outs for specific sectors and especially for security-sensitive sectors that partly alleviate any tensions.

170 A very notable example of such a scenario was the purchase by the Kuwait Investment Authority (‘KIA’) of a substantial stake (22%) in the oil company BP. The UK Mergers and Monopolies Commission reported that the purchase was likely to be ‘against the public interest’, mostly on grounds of national security and potential conflicts of interest between the UK and the KIA, because Kuwait is a sovereign state with its own broad interests which it might pursue through its stake, especially given the strategic importance of oil. As a consequence, it ordered KIA to sell more than half of its $5 billion stake in BP. See Mark Thatcher, *Western Policies towards Sovereign Wealth Funds Equity Investments: A Comparison of the UK, the EU and the US* (Policy Briefs, The London School of Economics and Political Science, London, UK, 2012); Reuters, ‘British Tell Kuwait to Cut BP Stake: Arab Oil Producer Could Lose $593 Million in Selloff’ *Los Angeles Times* (5 October 1988); see also UNCTAD (n 5) 31 for other examples.

171 See, eg, Article II.4, Trans-Pacific Partnership Agreement (signed in Auckland, New Zealand on 4 February 2016).

Nevertheless, the existence of a national security exception cannot and is not a trump card that can be played at will by host States. First of all, not all IIAs contain national security exceptions and, in their absence, these restrictions are difficult to justify. Secondly, the extent of regulatory space offered by these exceptions heavily depends upon the exact drafting of the provision itself. Finally, yet importantly, these carve-outs were obviously designed to shield some – usually security-sensitive – specific sectors from competition without having SWFs in mind. Indeed, some BITs even explicitly provide that public institutions, such as SWFs, are to be perceived as protected investors and covered by the Treaty.[172] Thus, given that host States are often wary of SWFs, irrespective of the economic sector they invest in, it is not at all clear that any interference with a SWF investment could be excused under the aforementioned carve-outs or exceptions.

Despite the absence of any arbitral awards dealing with this specific issue, host States have generally maintained that the existence and operation of foreign investment screening mechanisms and other similar schemes are justified on national security grounds. Indeed, as has been observed, the promotion of foreign investment and the maintenance of maximum regulatory space to pursue security interests are inversely correlated.[173] In that context, it is especially pertinent to examine whether the existing national security exceptions completely shield these schemes from scrutiny and, if not, define the appropriate balance between regulatory freedom and investment promotion that ought to be reflected in these provisions. Nonetheless, in light of the above, the interaction between IIAs and national security exceptions is very treaty-specific and context-specific and, thus, every situation needs to be assessed *in concreto*.

### 2. A Typology of National Security Exceptions and their Relationship with Foreign Investment Screening Mechanisms

First of all, it has to be noted that the landscape of IIAs is very fragmented. This means that, unlike the GATS, IIAs do not necessarily contain a national security exception and, even when they do, there is no uniform language across agreements.

172 See, eg, Article 1.3(iii), Agreement between the Government of Saudi Arabia and the Government of Malaysia concerning the Promotion and Reciprocal Protection of Investments (2000) which provides that 'the Government of the Kingdom of Saudi Arabia and its financial institutions and authorities such as the Saudi Arabian Monetary Agency, *public funds and other similar governmental institutions* existing in Saudi Arabia' (emphasis added).

173 UNCTAD (n 5) 126.

Consequently, every case needs to be assessed individually having as a venture point the exact terms of each agreement.

Indeed, even the existence of similar or identical terms across treaties does not automatically sanction a uniform interpretation, no matter how tempting and intellectually attractive this option might be.[174] The overarching purpose of the interpretative process should be to give effect to the true will of the Parties;[175] nevertheless, having that disclaimer in mind, it is not inappropriate to attempt to offer an approximate interpretation of similar terms across treaties in an effort approach the problem conceptually.

An analysis of BITs reveals that national security exceptions are only included in about 12 per cent of BITs; nevertheless, most recent FTAs with investment chapters contain such an exception.[176] Furthermore, a significant number of BITs concluded by States of importance to international investment flows such as the US, Germany,[177] Belgium, Luxembourg, the Netherlands, India[178] and Canada (after the mid-1990s)[179] do contain such an exception. In addition, a considerable number of countries include such

174 See Quincy Wright, 'The Interpretation of Multilateral Treaties' (1929) 23 American Journal of International Law 94, 103–104 where the author cautions against the 'misunderstandings that would result' from non-uniform interpretations.

175 See Judge de Castro (dissenting), *Aegean Sea Continental Shelf (Greece v Turkey)* (Jurisdiction) [1978] ICJ Rep 3, 63 who noted that:

> [I]t is a well-established principle that the purpose of interpretation is to ascertain the true will of the parties. The terms used in a declaration of intention must be regarded as the means […] to be used in order to reach a conclusion as to the intention of the authors of the declaration.

176 UNCTAD (n 5) 72.

177 See, eg, Protocol to the Agreement between the People's Republic of China and the Federal Republic of Germany on the Encouragement and Reciprocal Protection of Investments (2003).

178 See, eg, Article 11, Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of India for the Promotion and Protection of Investments (1994), which provides that 'nothing in this Agreement precludes the host Contracting Party from taking action for the protection of its essential security interests or in circumstances of extreme emergency in accordance with its laws normally and reasonably applied on a non-discriminatory basis'.

179 See Article 10(4), Canada Model Bilateral Investment Treaty, which adopts language virtually identical to NAFTA Chapter 11; see also Andrew Newcombe, 'Canada's New Model Foreign Investment Protection Agreement' (2004) 30 Canadian Council on International Law Bulletin 14.

provisions on an occasional basis[180] some of them being central to the SWF phenomenon (such as Qatar, China, Singapore and the United-Arab Emirates).[181]

Therefore, an attempted classification of the main types of these exceptions will be presented bearing in mind that each of these reflects a different compromise between regulatory space and the promotion of foreign investments. In that context, we will attempt to clarify whether foreign investment screening mechanisms are immune to review and whether their wide mandate could, as a matter of law, be justified under the existing national security exceptions contained in IIAs. Furthermore, given the possibility of review, we will also attempt to present the spectrum of different degrees of deference accorded to host States under the existing formulations. It will be submitted that most Agreements in place, despite offering a significant degree of regulatory space, are not wide enough to excuse an unrestricted and a*d hoc* blocking of SWFs' investments, as many host States currently maintain.

### 3. Foreign Investment Screening Mechanisms and the Customary Law Necessity Defence

Before we venture into an analysis of the national security exceptions contained in IIAs, it has to be noted that customary international law also provides for rules that govern 'the circumstances in which the wrongfulness of conduct […] may be precluded'; namely *force majeure*, distress and necessity.[182] One of the justifications for deviating from investment treaty obligations that has been invoked in issues touching upon security is the doctrine of necessity. To date, no State has invoked the doctrine of necessity in order to justify the blocking of an investment. Nevertheless, the doctrine has been invoked in disputes arising out of the Argentine debt crisis in order to justify measures violating other substantive provisions of the relevant BITs. In that context, some investment tribunals have conflated this doctrine with the treaty interpretation of national security exceptions and, thus, it is worth clarifying the concepts before we

180 Burke-White and Von Staden (n 118) 319.

181 See, eg, Agreement between the Government of the State of Qatar and the Government of the Republic of Turkey (2001); Agreement Between the Government of the People's Republic of China and the Government of the Republic of Singapore on the Promotion of Investments (1986); see also Agreement between the Government of the United Arab Emirates and the Swiss Federal Council on the Promotion and Reciprocal Protection of Investments (1998).

182 See Article 25, ILC Articles on State Responsibility (n 1) 49.

proceed to a specific analysis of the relationship between foreign investment screening mechanisms and national security exceptions.

The doctrine of necessity constitutes a principle of customary international law but its potential for abuse has led the ILC and international tribunals to be very cautious and interpret it strictly.[183] The ILC Commentary clarifies that 'necessity will only be rarely available to excuse non-performance of an obligation' and that it 'is subject to strict limitations to safeguard against possible abuse'.[184] In defining the conditions, the ILC stipulates that the act in question has to be '(a) the only way for the State to safeguard an essential interest against a grave and imminent peril; and (b) not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole'.[185] Even when these conditions are satisfied, the state must show that neither '[t]he international obligation in question excludes the possibility of invoking necessity', nor has '[t]he State […] contributed to the situation of necessity'.[186] This has even led some to suggest that a successful invocation of the principle in the context of investment law is 'extraordinarily difficult'.[187]

Unfortunately, some investment tribunals seem to have conflated the customary international law defence of necessity and national security exceptions contained in BITs ratified by Argentina.[188] Necessity − a principle of customary law as codified by the ILC − arises when a State has no other means available to safeguard an essential interest against a grave and imminent peril and can do so without impairing an essential interest of another State or the international community as a whole.[189] On the other hand, national security exceptions constitute treaty provisions and, as such, their precise

183 See August Reinisch, 'Necessity in International Investment Arbitration-An Unnecessary Split of Opinions in Recent ICSID Cases-Comments on CMS v. Argentina and LG&E v. Argentina' (2010) 41 Netherlands Yearbook of International Law 137.

184 ILC Articles on State Responsibility (n 1) 195 (commentary).

185 ibid 49 (Article 25.1).

186 ibid (Article 25.2).

187 Andrea K Bjorklund, 'Emergency Exceptions: State of Necessity and Force Majeure' in Peter Muchlinski, Federico Ortino and Chistoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (Oxford University Press, Oxford 2008) 520.

188 See *CMS Gas Transmission Company v Republic of Argentina* (ICSID Case No ARB/01/8) Decision on Objections to Jurisdiction, 17 July 2003; *Sempra v Argentina (Award)* (n 35) [376]; *Enron v Argentina (Award)* (n 35) [334] *et seq*.; see also Burke-White and Von Staden (n 118).

189 Article 25, ILC Articles on State Responsibility (n 1).

formulation and construction differs from Treaty to Treaty.[190] Furthermore, necessity is a legal basis for precluding wrongfulness after an internationally wrongful act has already been committed and, as such, constitutes a secondary legal rule. In contrast, national security exceptions excuse State conduct that would have otherwise been unlawful under a Treaty, on the basis that it is related to particular objectives the fulfilment of which warrants more regulatory space. As a consequence, no violation of a primary rule ever occurs.

Obviously, as the ICJ has recognised, both customary and treaty rules are applicable separately and independently of each other.[191] This however does not mean that we can automatically incorporate elements of the doctrine of necessity to the interpretation of national security exceptions. As argued, these two defences are operating at different levels and they are intended to deal with different situations. Interestingly, even the ICSID Annulment Committee seems to have indicated that such a conflation between the two concepts is erroneous. Indeed, in the *CMS v Argentina* case, it criticised the tribunal for not entering into a detailed analysis of the two concepts whilst it observed that article 25 of the ILC Articles would only become relevant once it had been established that there had been a breach of a substantive obligation. Perhaps regrettably, the decision was not annulled since the Committee acknowledged that it lacked the power to overturn the decision and noted that:

> [E]rrors made by the Tribunal could have had a significant impact on the operative part of the Award. As Admitted by CMS, the Tribunal gave an erroneous interpretation of Article XI.[192]

This decision probably also influenced the Award in the *Continental Casualty* case, which also clearly identified the difference between the two concepts, albeit it accepted

[190] See also *Military and Paramilitary Activities in and Against Nicaragua (Nicaragua v United States)* (n 21) [178] where the Court elaborated on the distinction between customary and treaty norms and stated that ‘even if two norms belonging to two sources of international law appear identical in content, and even if the States in question are bound by these rules both on the level of treaty-law and on that of customary law, these norms retain a separate existence’.

[191] ibid [179] where the Court stated that ‘customary international law continues to exist and apply, separately from international treaty law, even where the two categories of law have an identical content’.

[192] *CMS Gas Transmission Company v Republic of Argentina* (ICSID Case No ARB/01/8) Decision of the *ad hoc* Committee, 25 September 2007 [135].

that Article 25 ILC might have a role to play 'only insofar as the concept there used assist in the interpretation of Article XI itself'.[193]

However, and more importantly for the purposes of this thesis, what also becomes clear from this discussion is that the threshold for engaging the defence of necessity is quite high and, in fact, higher than that required for invoking most – if not all – national security exceptions in BITs, even the ones not containing a 'self-judging' element, as will be analysed later on. Given that the defence of necessity is a secondary rule of international law and it would have to be engaged after the invocation of a national security exception has failed, its invocation as a justification for blocking or interfering with a SWF investment is likely is futile and redundant. This doctrine could have a role to play in IIAs that *do not* contain a National Security exception as a justification for blocking a SWF investment but the threshold for its invocation is arguably impossible to meet. Perhaps a situation where the home State of an already established SWF investor becomes suddenly hostile (eg, in a regime change type of scenario) could potentially constitute a type of 'necessity' that would justify extraordinary measures. Arguably, a SWF could be then used as an instrument of foreign policy by the home State. Nevertheless, these cases would be rare and marginal.

### 4. IIAs without a National Security Exception and Foreign Investment Screening Mechanisms

As was noted earlier, the majority of IIAs do not contain any national security exceptions.[194] This omission is not without legal significance. Indeed, it indicates that there is no provision that could excuse a *prima facie* violation of the substantive provisions of the Agreement—at least on the basis of national security considerations.[195] However, this does not mean that the Parties would be impeded from taking any measures restricting foreign investment on national security grounds. What it rather means is that such measures ought to be in conformity with the rest of the agreement

193 *Continental Casualty Company v Argentina (Award)* (n 35) [160]–[168], *esp*. [168].

194 UNCTAD (n 5) 72.

195 See Diane A Desierto, *Necessity and National Emergency Clauses: Sovereignty in Modern Treaty Interpretation* (Martinus Nijhoff Publishers, The Netherlands 2012) 170 who also argues that absent any explicit or detailed language sanctioning the inapplicability of treaty provisions, it is the 'more reasonable presumption that contracting States intend to ensure continuous observance of all their treaty provisions in accordance with *pacta sunt servanda*'.

and, as such, respect, for instance, the principles of non-discrimination, the fair and equitable treatment standard and so on.[196] Arguably, the Agreement could instead maintain a negative listing system that offers a lot of flexibility to the Parties in terms of what sectors of their economy they would like to open up to foreign investors. In the absence of such a mechanism though, it ought to be accepted that any discriminatory interference with a SWF investment either pre- or post-establishment (depending on the type of BIT) is unlawful and even the existence of a foreign investment screening mechanism would be difficult to defend.

The absence of such a provision, however, does not mean that other secondary rules of international law as codified by the ILC are not engaged. It is very striking that, in a few instances, this absence has been interpreted as precluding the invocation of a state of emergency by the host State,[197] ignoring customary international law[198] and severely inhibiting the freedom of States to act in pursuit of their essential security interests. However, as explained, the threshold for invoking the customary law defence would be quite high anyway and, on that basis, it would be inapposite to justify a discriminatory interference with a SWF investment.

Despite this rather limited option, the striking conclusion is that the great majority of IIAs does not accord enough regulatory space to States to restrict or interfere with incoming and already established investments of SWFs. Especially in IIAs with pre-establishment provisions, this observation is quite significant since it renders the maintenance of foreign investment screening mechanisms rather questionable.

## 5. Self-Judging National Security Exceptions and Foreign Investment Screening Mechanisms

### *(i) Defining Self-judging Exceptions*

Turning to IIAs that do contain national security exceptions, what becomes crucial is identifying the degree of deference that they accord to host States. This primarily

196 UNCTAD (n 5) 120.

197 See, eg, Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Argentina for the Promotion and Protection of Investments (1990) 1765 UNTS 30682.

198 *BG Group Plc v The Republic of Argentina* (UNCITRAL) Award, 24 December 2007 [381]–[381].

depends on the exact language of these agreements and the exact drafting of the exception itself.

At the one end of the spectrum, we find Agreements that either explicitly exclude judicial review of the invocation of the national security exception (albeit this being an extremely rare type of IIA)[199] or contain self-judging language.

Case in point for such a maximum degree of deference is a number of IIAs concluded by the United States. For instance, the US – Bahrain BIT provides that:

> This Treaty shall preclude a party from applying a measure *which it considers* necessary for the fulfilment of its obligations with respect to international peace and security or the protection of its own essential security interests.[200]

Interestingly, the US did not always conclude BITs that contain this self-judging language. In fact, the US probably changed its practice after the unfortunate outcome of the *Nicaragua* case where the absence of self-judging language was perceived by the Court as allowing it to proceed to a judicial review of the measures taken by the US in violation of the relevant FCN Treaty.

The US in its two most recent Model BITs (2004 and 2012) has modified the language of its security exception clause to include 'self-judging' language. The provision now states that a party is precluded from taking measures that 'it considers necessary for the fulfilment of tis obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interest'.[201] Another important IIA that contains the same language is the Energy Charter Treaty in Article 24.[202]

A variation on the self-judging security exception theme is the combination of self-judging language with further qualifications, such as the enumeration of specific situations in which the national security exception can be invoked. The types of factual situations are quite similar and they draw heavily upon the conditions contained in the

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199 See, eg, Article 6.12, Comprehensive Economic Cooperation Agreement Between the Republic of India and the Republic of Singapore (2005) which provides that '[t]his Article shall be interpreted in accordance with the understanding of the Parties on non-justiciability of security exceptions as set out in their exchange of letters, which shall form an integral part of this Agreement'.

200 Article 14 , Treaty between the Government of the United States of America and the Government of the State of Bahrain Concerning the Encouragement and Reciprocal Protection of Investment (2002).

201 United States Model Bilateral Investment Treaty.

202 The Energy Charter Treaty (1999) 2080 UNTS 100.

WTO security exceptions. The three main categories of situations usually included are: a) trafficking; b) war and other emergencies in security relations; and c) the non-proliferation of nuclear weapons and fissionable materials in general. Obviously, this seems to limit the scope of application of the provision, hence increasing legal certainty and predictability, by making it more difficult for parties to invoke the clause.[203] In principle, it has been argued that States may be barred from adopting measures to protect their strategic industries under such an approach. In practice, however, the fact that these conditions are accompanied by self-judging language in the first part of the security exception complicates matters. This greatly increases the flexibility of the host State to invoke the exception since their judgment about whether these conditions are fulfilled would enjoy a much higher degree of deference. Additionally, the conditions are usually themselves phrased in vague and general terms that enhance the regulatory space of the host State. In any case, however, this formulation is more restrictive than a fully self-judging exception with no further qualifications. Further, this formulation is nearly identical to the one used under the WTO Agreements, as such, the standard applied ought to be quite similar.

In that context, the two main issues that need to be resolved regarding the self-judging nature of the exceptions are identical to the ones previously examined under the GATS. The first issue is whether the self-judging language of the national security exception precludes an arbitral tribunal from exercising its jurisdiction over its invocation, thus rendering the dispute non-justiciable. The second issue is the determination of the appropriate degree of deference that the tribunals should exercise—assuming the tribunal can judicially review the invocation of the exception that is. Ascertaining that degree of deference is of great relevance to the main question in this chapter; namely, whether the maintenance of foreign investment screening mechanisms can be justified under national security exception clauses.

*(ii) Jurisdiction and Justiciability*

Similarly to the debate about the self-judging security exception under the WTO Agreements, it has been suggested that investment tribunals should refrain from adjudicating issues touching upon national security and that the invocation of the exception bars the jurisdiction of the tribunal. Indeed, the wording used in self-judging

203 UNCTAD (n 5) 88.

security exceptions is strikingly similar to the language used in the GATT and the GATS. Therefore, the analysis of the WTO provisions that was presented earlier applies here *mutandis mutandis*. States must have imported these provisions *verbatim* in order to indicate that they wish to adopt a similar degree of deference when dealing with security issues. Therefore, and in antithesis to the few IIAs that explicitly exclude judicial review of security measures, even an unqualified self-judging exception is not completely beyond the jurisdiction of an investment tribunal.[204] Indeed, there have been no decisions accepting such an argument.

A very relevant international treaty illustrating this point is the NAFTA, also containing a national security exception virtually identical to GATT Article XXI, which seems to implicitly verify the aforementioned reasoning.[205] Indeed, despite the existence of an exception, NAFTA also provides further caveats linked to national security that would have been covered by a 'self-judging' security exception that bars any review whatsoever. More specifically, Article 1138 states that the Member States' decision to invoke the national security exception in order 'to prohibit or restrict the acquisition of

[204] Burke-White and Von Staden (n 118) 376–381; Jeswald W Salacuse, *The Law of Investment Treaties* (Oxford University Press, USA 2010) 345.

[205] Article 2102 , North American Free Trade Agreement, 32 ILM 289, 605 (1993), 699–700 which provides:

> 1. Subject to Articles 607 (Energy - National Security Measures) and 1018 (Government Procurement Exceptions), nothing in this Agreement shall be construed:
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> (a) to require any Party to furnish or allow access to any information the disclosure of which it determines to be contrary to its essential security interests;
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> (b) to prevent any Party from taking any actions that it considers necessary for the protection of its essential security interests;
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> (i) relating to the traffic in arms, ammunition and implements of war and to such traffic and transactions in other goods, materials, services and technology undertaken directly or indirectly for the purpose of supplying a military or other security establishment,
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> (ii) taken in time of war or other emergency in international relations, or;
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> (iii) relating to the implementation of national policies or international agreements respecting the non-proliferation of nuclear weapons or other nuclear explosive devices; or
>
> (c) to prevent any Party from taking action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.

an investment in its territory by an investor of another Party' is not subject to the dispute settlement mechanism of NAFTA Chapter 11 or 20.[206] The fact that the Parties made clear that the dispute settlement mechanism of the Treaty does not apply in some instances could be taken as evidence that it would apply in all others;[207] admittedly though, the Treaty contains language that explicitly leaves this question open.[208] It has been argued though that this strategic ambiguity was actually intended by the Parties as 'an appropriate way to address national security issues'.[209]

Furthermore, accepting such a proposition seems to run counter to the very purpose of the regime itself. Such an extreme degree of deference would only serve to fuel a climate of 'investment uncertainty' to the mutual detriment of both investors, who would be unable to estimate political and commercial risks, and States.[210] Evidently, such a situation can also result in inefficiencies throughout the international investment regime,[211] thus greatly augmenting the costs of foreign investment.[212]

In conclusion, it is submitted that self-judging exceptions in IIAs do not affect the jurisdiction and competence of arbitral tribunals and in fact allow for a limited judicial review of their invocation. Consequently, the question that naturally follows is how to define the proper of deference that investment tribunals should employ, when dealing with 'self-judging' national security exceptions.

206 ibid 647.

207 See Meg N Kinnear, Andrea K Bjorklund and John Hannaford, 'Article 1138 - Exclusions' in Meg N Kinnear, Andrea K Bjorklund and John Hannaford (eds), Investment Disputes under NAFTA An Annotated Guide to NAFTA Chapter 11 (Kluwer Law International 2006) 1138-1–1138-10.

208 Lindsay (n 31) 1301; Article 1128.1, NAFTA provides that the dispute settlement exclusion for private party actions applies 'without prejudice to the applicability or non-applicability of the dispute settlement provisions' in other actions involving the invocation of the National Security Exception.

209 ibid 1302.

210 See, eg, Kathryn Gordon, 'Investment Guarantees and Political Risk Insurance: Institutions, Incentives and Development' in *OECD Investment Policy Perspectives* (2008) 91–122.

211 See, eg, Rene M Stulz, 'On the Effects of Barriers to International Investment' (1981) 36 The Journal of Finance 923, 923–934.

212 Desierto (n 195) 200–202.

*(iii) 'Good faith' as the Standard of Deference*

This 'self-judging language' is rather indicative of a wider degree of 'deference' or of a wider 'margin of appreciation'[213] that should be accorded to the relevant State but, ultimately, it is submitted that the decision finds its outer limits in the principle of 'good faith'.[214] Indeed, investment tribunals have considered the principle of good faith to be part of customary international law and a general principle of law.[215]

Even the US, a main proponent of non-reviewability of these provisions, seems to be constructively ambiguous about whether there is some type of reviewable enforceable limit. For instance, in the context of a review of BITs conducted by UNCTAD, the US officially took the position 'that the determination of whether a measure is necessary for the protection of a country's essential security interests is a matter exclusively within its competence, not subject to review by any international tribunal'.[216] On the other hand, the Chairman of Senate Committee on Foreign Relations has noted that:

> [t]he United States considers this language to be 'self-judging', though, in the words of the State Department, 'each Party would expect the provisions to be applied by the other in good faith'.[217]

Further, in the context of NAFTA (which contains a self-judging exception), the US through its 'Statement of Administrative Action in the United States' NAFTA Implementation Act of 1993' acknowledges that the exception is to be used in good faith despite its self-judging character:

> Article 2102 governs the extent to which a government may take action that would otherwise be inconsistent with the NAFTA in order to protect its essential security interests. [..]. The national security exception is self-judging in nature,

213 See *infra* fns 246–253 and accompanying text for a discussion of the concept.

214 Burke-White and Von Staden (n 118) 370.

215 See Eric De Brabandere and Isabelle Van Damme, 'Good Faith in Treaty Interpretation' in Andrew D Mitchell, M Sornarajah and Tania Voon (eds), *Good Faith and International Economic Law* (Oxford University Press 2015) 41.

216 UNCTAD, *BITs in the mid-90s* (United Nations, New York, 1998) 98.

217 Senator Helms, *Bilateral Investment Treaties with Azerbaijan, Bahrain, Bolivia, Croatia, El Salvador, Honduras, Jordan, Lithuania, Mozambique, Uzbekistan, and a Protocol Amending the Bilateral Investment Treaty with Panama: Report by the Chairman of the Senate Committee on Foreign Relations* (Senate Executive Report 106-23, 2000).

> although each government would expect the provisions to be applied by the other in good faith.[218]

In any case, similarly to the analysis we performed for the national security exceptions under the WTO Agreement, there seems to be a consensus in state practice and academia that 'good faith' ought to be an outer enforceable limit upon State action, even when dealing with self-judging exceptions that offer a significant degree of regulatory freedom to the host State.

Another argument that has been put forth in favour of this interpretation is that it better maintains a balance between state autonomy and investor protection; indeed, under such a view, even when States have sought to preserve the widest freedom of action possible and transfer any accompanying risks to the investor, 'they cannot do so on mere pretext'.[219]

*(iv) The Substance of the 'Good Faith' Standard and its Application on Foreign Investment Screening Mechanisms*

The application of the principle of 'good faith' as an outer reviewable limit though is not particularly easy. As most general principles, good faith is an elusive, value-oriented concept that has not been defined in great detail. Indeed, it has been suggested that it is easier to explain what might not be a good faith interpretation of a treaty, namely 'an interpretation that is arbitrary, unreasonable, illogical, unfair, dishonest, deceptive, abusive or excessive'.[220]

Researchers under the auspices of Harvard University made an interesting attempt to articulate more clearly the components of the principle in the context of the University's research on the Law of Treaties, providing the following definition:

> [t]he obligation to fulfil in good faith a treaty engagement requires that its stipulations be observed in their spirit as well as according to their letter, and that what has been promised be

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218 NAFTA Implementation Act, Statement of Administrative Action, House of Representatives Document Number 103–159 (4 November 1993) 666.

219 Burke-White and Von Staden (n 118) 378; See also Tarcisio Gazzini, 'Interpretation of (Allegedly) Self-judging Clauses in Bilateral Investment Treaties' in Malgosia Fitzmaurice, Elias Olufemi and Panos Merkouris (eds), *Treaty Internpretation and the Vienna Convention on the Law of the Treaties: 30 Years On* (Martinus, Nijhoff, Leiden 2010) who even goes as far as suggesting that not even the subsequent agreement of the BIT parties that a security exception is completely self-judging cannot modify the acquired rights of the investors, as a result of the *sui generis* nature of international investment law.

220 De Brabandere and Van Damme (n 215) 39.

> performed without evasion or subterfuge, honestly, and to the best of the ability of the party which made the promise.[221]

Under such a definition, in the existence of evidence that a state is using a national security exception as a pretext for ulterior economic or even domestic political motives, a tribunal should have the competence to determine that the exception has not been invoked in good faith.[222] The lack of such evidence, however, would clearly satisfy the 'honesty and fair dealing prong of the good faith test'.[223]

Further, there is scant case law and state practice that could assist in clarifying the second aspect of the test, namely the 'rational basis' for the state's invocation of the provision. For instance, the International Whaling Commission analysed the good faith requirements of the UN Convention on the Law of the Sea. The Commission noted that good faith requires 'fairness, reasonableness, integrity and honesty in international behaviour' and when elaborating on the concept of reasonableness it highlighted that it demands the state to have some rational basis for its actions.[224] The threshold for such a reasonableness test, however, should be a very high one, especially since we are dealing with self-judging exceptions. The invocation of the exception would have to be manifestly absurd to satisfy such a requirement. For instance, Burke-White suggests that the adoption of a measure to defend against a security threat posed by aliens would be such an occasion.[225]

The combination of these two elements of a good faith test seems to be appropriate in the context of a self-judging security exception. It offers a very wide discretion and regulatory space for States to act when confronted with security issues but, at the same time, does not allow them to completely manipulate or abuse the system, by serving different interests. Indeed, it is submitted, even this limited outer limit would allow

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221 James W Garner, 'Codification of International Law: Part III – Law of Treaties' (1935) 29 American Journal of International Law (Supplement) 653, 981.

222 See for instance the case of Sweden and its decision to impose import quotas on footwear, *supra* fns 44−47 and accompanying text.

223 Burke-White and Von Staden (n 118) 380.

224 International Whaling Commission, *Resolution on Transparency within the International Whaling Commission (IWC/53/23rev – with revisions)* (2001).

225 Burke-White and Von Staden (n 118) 380.

tribunals to distinguish between justified national security concerns on the one hand, and measures constituting a disguised form of protectionism on the other.[226]

In applying such a standard, it has to be noted that the mandate provided to such foreign investment screening mechanisms seems to *prima facie* fall under the scope of national security exceptions. For instance, CFIUS reviews are limited to assessing the national security implications of foreign acquisitions of US businesses[227] and not consider, for instance, issues of economic security or of public interest, broadly defined.[228] Nevertheless, as explained earlier, States have been attempting to stretch the limits of the notion of 'national security' to cover a wider variety of factual situations. An arbitral tribunal confronted with such a scenario would be tempted to resist this widening of the scope of the term and apply a stricter notion of national security that would be more in line with what the drafters of the Treaty had in mind. In such a scenario, it is not unlikely that the invocation of a national security exception to justify a discriminatory or expropriatory interference with a SWF's investment would be found to be in bad faith.

Nevertheless, assuming that the factual situation would fall under the scope of such a stricter notion of national security, there would further be serious evidentiary issues. The monitoring procedures are usually quite opaque, not subject to domestic judicial review whilst the information on the basis of which the decision is made is often classified or highly sensitive.[229] Indeed, it is likely that the information collected might concern key people involved in the transaction collected through clandestine means.[230] Overall, decisions taken to confront national security threats are made on the basis of asymmetrical information that remains private and – in a typical prisoner's dilemma scenario – the host State has no incentive to reveal. In these circumstances, it is difficult to see how a tribunal would ever be in a position to request – let alone receive and assess – this information in order to effectively review a particular decision. Nevertheless, as

226 UNCTAD (n 5) 40–41.

227 See Defense Production Act of 1950, as amended, 50 USC App.

228 ibid.

229 Mendenhall (n 92) 350.

230 ibid 350.

we mentioned earlier, leaks of classified documents are becoming quite common these days so this line of defence might prove to be less effective than previously assumed.

Therefore, it is submitted that – despite the serious evidentiary issues – the invocation of 'national security' in order to protect certain industries or prevent SWFs from investing on political or regulatory grounds constitutes a bad faith invocation of a national security exception. Admittedly though, arbitral tribunals would be quite reluctant to stretch the limits of their mandate and strike down such decisions, whilst receiving sufficient evidence to that end seems implausible.

## 6. IIAs with National Security Exceptions that Qualify their Invocation and Foreign Investment Screening Mechanisms

### *(i) 'Necessity' as an Objective Standard*

Further in this continuum, we find IIAs that require 'necessity' as an objective precondition for invoking a national security exception,[231] arguably the most common formulation. Furthermore, several IIAs contain similar terms such as 'required',[232] 'directed to'[233], 'have to be taken in',[234] which arguably describe a progressively more lenient nexus.

One of the most notorious security exceptions of this sort is the one contained in the Argentina-US BIT:

> The Treaty shall not preclude the application by either Party of measures necessary for the maintenance or restoration of international peace and security, or the protection of its own essential security interests.[235]

[231] See, eg, Article X, Treaty Between the United States of America and the Republic of Bulgaria Concerning the Encouragement and Reciprocal Protection of Investment (1994), which provides that '[t]his Treaty shall not preclude the application by either Party of measures *necessary* for the maintenance of public order, the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests (emphasis added).

[232] See, eg, Article 3.2, Agreement between the Republic of Uganda and the Belgo-Luxembourg Economic Union (2005).

[233] See, eg, Article 8.3, Agreement between the Government of Hong Kong and the Government of New Zealand for the Promotion and Protection of Investments 1748 UNTS 385 (1993).

[234] See, eg, Ad Article 3, Treaty concerning the Encouragement and Reciprocal Protection of Investments between the Federal Republic of Germany and Burundi (1984).

[235] Article XI, Agreement Between the United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment (14 November 1991) 31 ILM 124, 135.

In the context of Argentina's sovereign debt crisis, there have been several ICSID cases involving US claimants, in the course of which Argentina has always invoked the said security exception, arguing it is self-judging.[236] The tribunals disagreed with the argument and characterised the provision as not self-judging.[237] In fact, they proceeded to a substantive review of Argentina's invocation of the clause rather than merely a 'good faith' test. Notably, though, they explicitly recognised that had the provision been self-judging, a 'good faith' test would be applicable anyway.[238]

The tribunals, however, have justified their decision differently. The arbitrators in *CMS v Argentina* justified their interpretation by focusing on a textual comparison between the relevant provision and other treaty provisions, such as GATT Article XXI, that use explicit self-judging language:

> [W]hen States intend to create for themselves a right to determine unilaterally the legitimacy of extraordinary measures importing non-compliance with obligations assumed in a treaty, they do so expressly. The examples of the GATT [Article XXI] and bilateral investment treaty provisions offered above are eloquent examples of this approach.'[239]

In so doing, they also cited the ICJ which, in the Nicaragua case, adopted a similar reasoning with respect to an exception clause in an NFC Treaty between the US and Nicaragua.

In contradistinction, the *LG&E* and *Enron* tribunals minimised the importance of the language of the Treaty and they, instead, focused on ascertaining the true intentions of the Parties at the time of the conclusion of the Agreement. Eventually, they found that

236 For an extensive discussion on these cases see Michael Waibel, 'Two worlds of Necessity in ICSID arbitration: CMS and LG&E' (2007) 20 Leiden Journal of International Law 637; Bjorklund (n 207); Jürgen Kurtz, 'Adjudging the Exceptional at International Investment Law: Security, Public Order and Financial Crisis' (2010) 59 International and Comparative Law Quarterly 325; Reinisch (n 183); Alberto Alvarez-Jiménez, 'The Interpretation of Necessity Clauses in Bilateral Investment Treaties after the Recent ICSID Annulment Decisions' in Karl P Sauvant (ed), *Yearbook on International Investment Law & Policy 2010/2011* (Oxford University Press, New York).

237 *Enron v Argentina (Award)* (n 35) [29]; *LG&E Energy Corp, LG&E Capital Corp and LG&E International Inc v Argentine Republic* (ICSID Case No ARB/02/1) Decision on Liability, 3 December 2006 [212]; *CMS v Argentina (Award)* (n 35) [373]; *Sempra v Argentina (Award)* (n 35) [371].

238 *Enron v Argentina (Award)* (n 35) [339]; *LG&E v Argentina (Decision on Liability)* (n 35) [214]; *CMS v Argentina (Award)* (n 35) [374]; *Sempra Energy International v Argentine Republic* (ICSID Case No ARB/02/16) Award, 28 September 2007 (n 35) [388].

239 *CMS v Argentina (Jurisdiction)* (n 188) [270].

the provision was not meant to be self-judging.[240] Lastly, the *Sempra* tribunal interpreted the exception through the lens of the object and purpose of the treaty. The outcome of this exercise was a restrictive interpretation of the exception; the object and purpose of the Treaty was perceived to be the protection of investors, exactly in situations of anomaly like the one at hand.[241]

Irrespective of the exact justification of their pronouncement, there is strong support for the proposition that national security exceptions are not inherently self-judging and that provisions that do not contain explicitly self-judging language invite a higher degree of scrutiny from the relevant arbitral tribunal.[242] In that context, it has been argued that the silence of the text should not be interpreted as an invitation to full judicial review by the relevant tribunals. Further, any interpretation of the term 'necessary' ought to take that a certain degree of deference was probably intended by the Parties. Indeed, as Sir Hersch Lauterpacht recognised, it is 'doubtful whether any tribunal acting judicially can override the assertion of a state that a dispute affects its security'.[243]

The appropriate standard of review – and, thus, the appropriate degree of deference –remains to be determined. Undoubtedly though, such a standard is contingent upon the interpretation of the word 'necessary'. This is obviously a matter of contention, not just in this context, but also generally in IEL, and a suggestion will be put forth later on in this section, after presenting the different options that have been put forth.

(a) Strict 'necessity' as interpreted by the ICJ

The concept of 'necessity' is of frequent occurrence in international law, albeit there are several different approaches as to how properly define it. As we established earlier,

240 *LG&E v Argentina (Decision on Liability)* (n 35) [212]; *Enron v Argentina (Award)* (n 35) [337].

241 *Sempra Energy International v Argentine Republic* (n 35) [373]–[374]; this decision seems to echo the reasoning of the *SGS v Philippines* tribunal which, in the context of interpreting the BIT's 'observance of undertakings' clause, it noted that since the purpose of the BIT is to create and maintain favourable conditions for investments, '[i]t is legitimate to resolve uncertainties in its interpretation so as to favour the protection of covered investments'; see *SGS Société Générale de Surveillance SA v Republic of Philippines* (ICSID Case No ARB/02/6) Decision on Jurisdiction, 29 January 2004 [116].

242 Interestingly, the US to this day maintains that there is no distinction between provisions containing the 'it considers' self-judging language and the ones containing 'necessity' language and that all of them ought to be unreviewable by dispute settlement bodies. Nevertheless, in its two latest model BITs, it has had changed the language of the Security Exception in order to incorporate self-judging language. For more, see Mendenhall (n 92) *esp*. 243; see also Gazzini (n 219) 239.

243 Lauterpacht (n 113) 188.

the meaning of necessity under the customary doctrine of 'necessity' ought to be inapplicable in the interpretation of national security exceptions. A second approach for interpreting the term in IIAs would be the one followed by the ICJ when it interpreted a similar term contained in an FCN Treaty between the US and Nicaragua. The Court there noted that 'the measures taken must not merely be such as to tend to protect the essential security interests of the party taking them but must be '"necessary" for that purpose'.[244] More recently, in 2003, the Court was called on again to interpret the term 'necessary' contained in the US-Iran FCN Treaty. In that case, however, there was an overlap between this provision and the conditions of Article 2(4) of the UN Charter and, as a result, the Court stated:

> The Court does not however have to decide whether the United States interpretation of Article XX, paragraph 1 (d), on this point is correct, since the requirement of international law that measures taken avowedly in self-defence must have been necessary for that purpose is strict and objective, leaving no room for any "measure of discretion".[245]

In any case, it seems that the Court is generally inclined to interpret the term 'necessary' in national security exceptions in a restrictive manner. Arguably, the context surrounding the invocation of these provisions was significantly different (eg, situations where there was an alleged use of force) and, as such, it seems inappropriate to incorporate such a strict interpretation in IIAs whose object and purpose is significantly different. The protection of foreign investment does not warrant the same level of protection as the collective security system established by the UN Charter.

(b) 'Necessity' and the 'margin of appreciation doctrine'

A different approach has evolved in the jurisprudence of the ECHR,[246] which has developed the doctrine of the 'margin of appreciation', as a vernacular to actually express this enhanced degree of deference that might be appropriate when dealing with

244 *Military and Paramilitary Activities in and Against Nicaragua (Nicaragua v United States)* (n 21) [282].

245 *Oil Platforms (Islamic Republic of Iran v United States of America)* (n 23) [73].

246 For a complete overview and a detailed account of the specificities of this doctrine see Howard C Yourow, *The Margin of Appreciation Doctrine in the Dynamics of European Human Rights Jurisprudence*, vol 28 (Martinus Nijhoff Publishers 1996); see also Michael R Hutchinson, 'The Margin of Appreciation Doctrine in the European Court of Human Rights' 48 International and Comparative Law Quarterly 638.

such exceptions. This doctrine, applicable also in other areas of international law,[247] EU law[248] and WTO law,[249] has been described as a tool of judicial deference and self-restraint. It prescribes that there often is a certain *range* of actions and behaviours that a State could engage in, and simultaneously satisfy the requirements of an applicable international obligation. According to this doctrine, the exercise that a tribunal ought to perform is delineating the boundaries of the margin and, thus, the boundaries of state action. These boundaries could differ according to the specific factual nexus that underlies each case. Namely, more deference would be offered to States when dealing with highly abstract and context- or treaty-specific concepts such as national security or public morality, and less when confronted with standards of a more objective nature, such as public health.

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247 See Yuval Shany, 'Toward a General Margin of Appreciation Doctrine in International Law?' (2005) 16 European Journal of International Law 907.

248 See, eg, Case C-83/94 *Germany v Leifer* [1995] ECR I–3231where the Court held that the Member States have discretion in invoking the security exception to Community legislation which generally bars the introduction of unilateral sanctions on third states; see also Case C-273/97 *Sirdar v Army Bd* [1999] ECR I–7403 *esp*. [27]; Case C-368/95 *Vereinigte Familiapress Zeitungsverlags- und vertriebs GmbH v Heinrich Bauer Verlag* [1997] ECR I–3689 [3716]; Case C-260/89 *Elliniki Radiophonia Tileorassi AE (ERT) v Dimotiki Etairia Pliroforissis (DEP)* [1991] ECR I–2925 [2960]; Case C-186/01 *Dory v Bundesrepublik Deutschland* [2003] ECR I–2479 [36]; Case C-285/98 *Kreil v Bundesrepublik Deutschland* [2000] ECR I–69 [105]; Case 131/79 *R v Secretary of State for Home Affairs* [1980] ECR 1585 [1600]–[1611]; Case 34/79 *R v Henn* [1979] ECR 3795 [3818]–[3814].

249 See, eg, *EC – Asbestos (AB)* (n 162) [168] where the AB held that 'it is undisputed that WTO Members have the right to determine the level of protection of health that they consider appropriate in a given situation'; see also *US – Underwear* Panel Report, United States – Restrictions on Imports of Cotton and Man-made Fibre Underwear, WT/DS24/R, adopted 25 February 1997, as modified by Appellate Body Report WT/DS24/AB/R, DSR 1997:I, 31 [7.13]; *Argentina – Footwear (EC)* Appellate Body Report, Argentina – Safeguard Measures on Imports of Footwear, WT/DS121/AB/R, adopted 12 January 2000, DSR 2000:I, 515 [12]; see also Article 17.6 of the Antidumping Agreement which explicitly codifies the standard:

> (i) in its assessment of the facts of the matter, the panel shall determine whether the authorities' establishment of the facts was proper and whether their evaluation of those facts was unbiased and objective. If the establishment of the facts was proper and the evaluation was unbiased and objective, even though the panel might have reached a different conclusion, the evaluation shall not be overturned; (ii) the panel shall interpret the relevant provisions of the Agreement in accordance with customary rules of interpretation of public international law. *Where the panel finds that a relevant provision of the Agreement admits of more than one permissible interpretation, the panel shall find the authorities' measure to be in conformity with the Agreement if it rests upon one of those permissible interpretations*' (emphasis added).

In more detail the Court has accepted that fundamental rights can be restricted to the extent 'necessary in a democratic society' for the protection of, *inter alia*, national security. In defining the term 'necessary' it has proclaimed that:

> [W]hilst the adjective 'necessary', within the meaning of Article 10 para. 2, is not synonymous with 'indispensable' (cf., in Articles 2 para. 2... and 6 para. 1, the words 'absolutely necessary' and 'strictly necessary' and, in Article 15 para. 1,the phrase 'to the extent strictly required by the exigencies of the situation'), neither has it the flexibility of such expressions as 'admissible', 'ordinary' (cf. Article 4 para. 3), 'useful' (cf. the French text of the first paragraph of Article 1 of Protocol No. 1), 'reasonable' (cf. Articles 5 para. 3 and 6 para. 1) or 'desirable'.[250]

Therefore, the Court has interpreted the term 'necessary' as falling somewhere between the poles of 'indispensability' and 'desirability' but it has, nevertheless, recognised that the relevant State has a significant 'margin of appreciation' to make that judgment. The breadth of the margin depends on the particular provision of the Convention being applied, yet – in nearly all cases – it is significantly wider than the same term in the context of the customary law of necessity for instance.[251]

Indeed, it has been suggested that the 'margin of appreciation doctrine' could be utilised by investment tribunals.[252] The justification for this would be the implausibility of States having delegated the authority to make a determination of their security interests to a third-party *ad hoc* tribunal. Additionally, the argument goes, investment tribunals do not have the fact-finding capacity to successfully make such a review whilst the complete absence of deference would end up undermining the investment regime itself.[253]

Therefore, and in the context of this thesis, a state measure aimed at protecting strategic industries from competition might be more difficult to justify than a situation where a military threat has materialised. Similarly, the current practice of States towards SWFs seems to be problematic, even with respect to such a highly deferential standard.

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[250] *Handyside v United Kingdom* 24 ECtHR (ser A) [1976] 22 [48].

[251] Burke-White and Von Staden (n 118) 346.

[252] ibid 370 *et seq*.

[253] ibid 373; on the legitimacy of the ICSID system see also Susan D Franck, 'Foreign Direct Investment, Investment Treaty Arbitration and the Rule of Law' (2007) 19 McGeorge Global Business and Development Law Journal 337.

For instance, the blocking of the Chinese SWF investment in solar panels would be very difficult to justify. If, however, the measure at stake concerned an Iranian company and a high-tech or military industry then such a measure would most likely be excused.

(c) The 'less trade-restrictive alternative' as the preferred standard

Last but not least, the GATT and WTO Panels have developed a different approach to the term 'necessary' that could, in a nutshell, be described as the 'least trade-restrictive alternative' to the fulfilment of a certain policy goal. For instance, in *Thailand – Cigarettes*, the Panel stated that:

> [T]he import restrictions imposed by Thailand could be considered to be 'necessary' in terms of Article XX (b) only if there were no alternative measure consistent with the General Agreement, or less inconsistent with it, which Thailand could reasonably be expected to employ to achieve its health policy objectives.[254]

The WTO Panel and AB in *US – Gasoline* affirmed the principle that trade restrictions can only be considered 'necessary' if there are no alternative measures consistent with the GATT, or less inconsistent with it, to achieve the environmental protection objectives at hand there.[255]

Arguably, the standard employed by the WTO seems to be the most apposite for International Investment Law as well. Indeed, the protection of trade is functionally similar if not identical to the protection of another factor of production, namely capital. Further, the normative overlap and synergies between these two bodies of law indicate that similar standards ought to be employed, unless otherwise dictated by the context and object/purpose of the specific agreement in question. In any case, this standard seems to be narrower than the one used under 'margin of appreciation' doctrine under the ECHR—and rightly so.[256] The context there is rather different since we are dealing with a very intrusive and comprehensive system of human rights' protection that could even clash with domestic constitutional provisions.

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254 *Thailand – Cigarettes* GATT Panel Report, Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes, DS10/R, adopted 7 November 1990, BISD 37S/200 [75].

255 *United States – Gasoline (AB)* (n 127) [III(B)]; see also *US – Gasoline* Panel Report, United States – Standards for Reformulated and Conventional Gasoline, WT/DS2/R, adopted 20 May 1996, as modified by Appellate Body Report WT/DS2/AB/R, DSR 1996:I, 29 [6.22]–[6.29].

256 Burke-White and Von Staden (n 118) 348.

Under this 'less trade restrictive' approach, arbitrators are given the competence to decide whether the respective host country measure was indeed required to respond to a perceived security threat, or whether there would have been less severe means with a smaller impact on the investment. For example, in the absence of a self-judging security exception, an arbitral tribunal could assess whether a general ban on foreign investment in a specific industry or a more specific blocking of an investment because of the identity of the investor (eg, a SWF) is excessive and, as result, not excused under the relevant security exception of the IIA. This would have to necessarily be a balancing process and would expose the host State to a curtailing of its available policy responses. Thus, this approach would permit some form of proportionality test to be performed by the arbitrators and would, thus, reduce the regulatory discretion of the Parties.

Further, as suggested in the *US – Tuna (I)* GATT report – which remained unadopted – an appropriate yardstick for 'consistency' of measures intended to protect the environment with the GATT, was the attempted ongoing, or completed negotiation of international cooperative agreements.[257] Making an argument by analogy from this, the appropriate benchmark could be interpreted as including evidence of multilateral support for the restrictive measures used.[258] For instance, compliance of a SWF with the Santiago Principles could indicate that any restriction of its investment activity is probably unnecessary and, thus, not excused under the relevant security exception.

Therefore, it is suggested that IIAs that have adopted a 'necessity' formulation for the successful invocation of a national security exception – and constitute the majority of IIAs with a security exception – ought to adopt a conceptualisation of necessity that is akin to the 'less trade restrictive' standard developed in WTO Law. Under such a standard, however, individual decisions by foreign investment screening mechanisms would be scrutinised and often found not to conform to that standard.

Arguably, this standard would not differ hugely from a 'good faith' standard. Admittedly, a good faith standard accords more deference to the host State and only in cases where there are profound violations or abuses of the Agreement, a measure could be found to be unlawful. Even the most deferential standard, however, would be sufficient to distinguish measures genuinely geared towards protecting national security

257 *US – Tuna (Mexico)* GATT Panel Report, United States – Restrictions on Imports of Tuna, DS21/R, DS21/R, 3 September 1991, unadopted, BISD 39S/155, 1620.

258 Browne (n 67) 426.

from protectionist measures. The difference between these two standards would be the standard of proof; in the first case, absent'smoking gun' or overwhelming evidence, proving a bad faith invocation of the exception would be next to impossible.

*(ii) Other Objective Standards*

At the far end of the spectrum, we find Agreements that subject the invocation of the exception to even further qualifications or conditions and go far as sanctioning a full judicial review of the host State's decision by an international arbitral tribunal—at least when it comes to these conditions. These conditions are usually either further clarifying a general necessity requirement or qualify and restrict the host State's ability to pursue its national security interests. Indeed, the vast majority of IIAs that include a national security exception qualify its successful invocation upon further conditions. Some of them are the absence of 'arbitrary or unjustifiable discrimination',[259] the application of the measure on a non-discriminatory basis,[260] the absence of a 'disguised restriction on trade or investment'.[261] These conditions arguably further clarify the necessity requirement or reaffirm the principle of non-discrimination even in the context of security-related measures. Consequently, they could be read as an affirmation of the will

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259 See, eg, Article 99, Agreement Between Japan and the Republic of the Philippines for an Economic Partnership (2006), which provides that nothing in the Agreement−

> shall be construed to prevent a Party from adopting or imposing measures […] which it considers necessary for protection of its essential security interests […] subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination against the other Party […].

260 See, eg, Article 12, Agreement between the Republic of Hungary and the Republic of India for the Promotion and Protection of Investments (2003), which provides that:

> [n]otwithstanding paragraph 1 of this Article nothing in this Agreement precludes the host Contracting Party from taking action for the protection of its essential security interests or in circumstances of extreme emergency *in accordance with its laws normally and reasonably applied on a non-discriminatory basis*' (emphasis added).

261 See, eg, Article 13, Framework Agreement on the ASEAN Investment Area (2012), which provides that:

> [s]ubject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a *disguised restriction on investment flows*, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member State of measures; (a) necessary to protect national security and public morals' (emphasis added).

of the Parties to prevent each other from taking protectionist measures under the pretext of a security threat or to protect their strategic industries from foreign takeovers.[262]

It becomes clear that under these qualifications, a discriminatory or arbitrary decision to block a SWF investment or an order to divest would be very questionable. As such, the invocation of a national security exception will most likely fail.

## D. Interim Conclusion

The aforementioned analysis revealed that the operation and maintenance of foreign investment screening mechanisms by host States – the mechanism usually used to interfere with a SWF investment – is far from being legally 'shielded' from scrutiny under IEL.

Obviously, national security is a policy area of great sensitivity and States have reserved for themselves a great deal of discretion regarding when dealing with situations that might be infringing upon it. Nevertheless, the 'national security exceptions' contained in most IEL instruments were never envisaged as a 'get out of jail free card' to escape from international legal obligations at will, nor as an 'escape valve' for commercial considerations. These provisions were included to offer States a significant – but varying – degree of deference when dealing with potential or realised national security threats.

Under WTO Law, States have chosen to adopt a formulation that uses 'self-judging' language along with describing some explicitly enumerated conditions under which the exception can be engaged. This choice accords States a wide degree of deference but does not go as far as limiting the jurisdiction or competence of the WTO dispute settlement body to resolve a dispute. At the very least, there is an outer enforceable 'good faith' limit that ought to be respected. Even under this very deferential standard though, SWFs' investments that are being blocked at the pre-establishment stage on the basis of commercial – or worse, populist – considerations would not be in conformity with the law as it stands. Admittedly, there are profound evidentiary difficulties as to how to prove such a misuse of the national security exception but – at least normatively ––the current state of affairs and the treatment of SWFs by foreign investment screening mechanisms is legally questionable.

262 UNCTAD (n 5) 84.

Under the universe of IIAs, the answer to the questions posed is much more treaty-specific but, nevertheless, lead to similar conclusions. First of all, most IIAs do not even contain national security exceptions whilst a significant number of the ones that do contain one, choose a ‘necessity standard’ that is quite restrictive. Under this more stringent standard, interference with SWFs’ investments on the basis of some tenuous link with national security considerations would be found to be unlawful. Furthermore, restrictions on SWFs’ investments that are excessive or arbitrary would also not be in conformity with the rules. Of course, there is a significant number of IIAs that contains ‘self-judging’ language – arguably the more deferential choice of wording – but, similarly to the GATS national security exception, such a formulation does not permit anything under the sun. Good faith would again be an outer enforceable limit.

As an overall conclusion, it has to be accepted that frivolous or abusive invocations of national security exceptions in order to serve – cumulatively or conjunctively – non security-related considerations have never been tolerated in the international practice—let alone legitimised through instruments of IEL. Nevertheless, the use of foreign investment screening mechanisms to interfere or block SWFs’ investments is very often only a pretext for concealing considerations of a very different nature, be it regulatory or populist. In that context, it is submitted that the current state of affairs should not be tolerated and it ought to be accepted that – at least normatively – dealing with SWFs at the pre-establishment stage of their investments is highly problematic—if not legally questionable. Accepting that will only serve to strengthen the system; if measures that serve both security and non-security interests are to be judicially reviewed by adjudicating bodies, then States will be less inclined to exploit this grey area and much more willing to devise or specify good policies.

SWFs are indeed a unique breed of investor and trader in services and they should by all means be regulated differently. Indeed, there might even be cases where essential security interests are being at stake, for instance in case of a SWF investment in a defence industry. In most cases, however, the current *ad hoc* approach to the admission and establishment of their investment in the field of services is simply arbitrary.

# VI. SUMMARY OF CONCLUSIONS

This study attempted to approach the phenomenon of SWFs under the relevant disciplines of IEL. In that context, the *status quo* was presented, its legality was examined and an alternative normative proposal was made—one that made use of a different interpretation of the principle of non-discrimination under both Trade and Investment Law. As the main results developed in the course of this work have been summarised in a concluding section at the end of each of four parts, this final part completes the thesis with a concise summary of all conclusions.

In Chapter II of this thesis, the modern-day phenomenon of SWFs and their increasingly important role in the field of investment in services was presented. It was argued that SWFs are a new particular class of investors that have been expanding in developed markets and, as a result, have attracted a lot of – and very often unwelcome − attention. The definitions that have been put forth for SWFs were presented but, ultimately, it was suggested that their only relevant distinguishing characteristic is their government ownership. For the most part, the fact that they are government-owned has caused host States to voice a series of regulatory concerns that might accompany their operation within their markets. Such concerns are related to corporate governance, competition policy, transparency and national security. Nonetheless, it seems that in order to address these concerns, most host States have responded disproportionately. Namely, host States of SWF investments have enhanced the competencies of foreign investment screening mechanisms in order to be in a position to restrict or even block incoming SWF investments at will—usually by framing their concerns in the language of national security. As a result, the response of host States so far has been to attempt to address the issue 'at the border' and maintain an almost unfettered discretion to block SWF investments.

In Chapter III of the thesis, it was argued that the current approach of host States to the challenges posed by SWFs is of questionable lawfulness under the relevant disciplines of IEL. Indeed, it was argued that the GATS – assuming market access commitments have been made – would not permit the maintenance of foreign investment screening mechanisms that have the potential to block inwards investment and, as a result, inhibit the establishment of commercial presence in the relevant market. Additionally, such mechanisms would also be prohibited under several 'Liberalisation BITs' or most of the recent FTAs that contain investment chapters. Indeed, these agreements extend their non-discrimination protections at the pre-establishment stage and, as a result, these mechanisms would be unlawful, as they are inherently discriminatory.

In Chapter IV of the thesis, and as a response to the aforementioned conundrum, a new normative suggestion was put forth. Namely, it was suggested that instead of dealing with the issue of SWFs 'at the border' − and arguably unlawfully − host States could remove these barriers to the entry of SWFs and address their regulatory concerns post-establishment. Nonetheless, for such an approach to be useful, IEL would need to accord States adequate 'regulatory space' to address these concerns. Therefore, the crux of the matter regarding the post-establishment regulation of SWFs was identified: the construction of the principle of non-discrimination under both the GATS and International Investment Law. It that context, two arguments were made to elucidate the operation of the principle. First, it was argued that the normative overlaps between the two regimes – which become more pronounced in the case of SWFs – command a comparative and contextual approach to the principle that yields similar results. In other words, it would be undesirable for the principle to accord different degrees of regulatory freedom under the two regimes. Secondly, it was argued that the principle of non-discrimination ought to be interpreted in a way that takes into account the 'regulatory' or 'policy likeness' between different market suppliers/investors in a dispositive fashion. Under the interpretation that was put forth, host States would be allowed to draw regulatory distinctions between SWFs and other economic entities that operate within their market. As a result, a more efficient outcome would be achieved: investment would be promoted but not at the expense of necessary governmental regulation.

In Chapter V of the thesis, possible deviations from the substantive protections of IEL on the grounds of national security were presented. Indeed, several host States have maintained that most, if not all, regulatory concerns, that flow from the operation of SWFs are, in essence, issues of national security. As a result, they have argued that any regulations addressing these concerns ought to be exempted from scrutiny. If that were to be true, then our analysis so far would be largely superfluous, since IEL does contain relevant national security exceptions. Nonetheless, the analysis of national security exceptions revealed that host States cannot simply invoke them at will and escape scrutiny: abusive or frivolous invocations have never been accepted in international practice and the notion of national security has generally been interpreted more restrictively that commonly assumed. Under such an analysis, host States would simply not be allowed to conceal populist or protectionist intentions under the guise of national security. Indeed, SWF investments could only be blocked in limited circumstances that concern the national security of the host State *stricto sensu*, such as a SWF investment in the defence industry.

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