

**United Nations Conference on Trade and Development**

**THE PROTECTION OF  
NATIONAL SECURITY  
IN IIAs**

**UNCTAD Series on  
International Investment Policies for  
Development**



**UNITED NATIONS**  
New York and Geneva, 2009

## NOTE

As the focal point in the United Nations system for investment and technology, and building on 30 years of experience in these areas, UNCTAD, through its Division on Investment and Enterprise (DIAE), promotes understanding of key issues, particularly matters related to foreign direct investment and transfer of technology. DIAE also assists developing countries in attracting and benefiting from foreign direct investment, and in building their productive capacities and international competitiveness. The emphasis is on an integrated policy approach to investment, technological capacity-building and enterprise development.

The term “country” as used in this study also refers, as appropriate, to territories or areas; the designations employed and the presentation of the material do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area, or of its authorities, or concerning the delimitation of its frontiers or boundaries. In addition, the designations of country groups are intended solely for statistical or analytical convenience and do not necessarily express a judgement about the stage reached by a particular country or area in the development process.

The following symbols have been used in the tables:

Two dots (..) indicate that data are not available or are not separately reported;

Rows in tables have been omitted in those cases where no data are available for any of the elements in the row;

A dash (-) indicates that the item is equal to zero or its value is negligible;

A blank in a table indicates that the item is not applicable;

A slash (/) between dates representing years, e.g. 1994/95, indicates a financial year;

---

---

Use of a dash (–) between dates representing years, e.g. 1994–1995, signifies the full period involved, including the beginning and end years;

Reference to dollars (\$) means United States dollars, unless otherwise indicated;

Annual rates of growth or change, unless otherwise stated, refer to annual compound rates;

Details and percentages in tables do not necessarily add up to the totals because of rounding.

The material contained in this study may be freely quoted with appropriate acknowledgement.

UNCTAD/DIAE/IA/2008/5

UNITED NATIONS PUBLICATION
<i>Sales No. E. 09.II.D.12</i>
ISBN 978-92-1-112772-0
ISSN 1814-2001

Copyright © United Nations, 2009  
All rights reserved  
Printed in Switzerland



---

---

## PREFACE

The secretariat of the United Nations Conference on Trade and Development (UNCTAD) is implementing a programme on international investment arrangements. The programme seeks to help developing countries participate as effectively as possible in international investment rulemaking. It embraces policy research and development, including the preparation of a series of issues papers; human resources capacity-building and institution-building, including national seminars, regional symposia, and training courses; and support for intergovernmental consensus-building.

This paper is part of the new *Series on International Investment Policies for Development*. It builds on and expands UNCTAD's *Series on Issues in International Investment Agreements*. Like the previous series, this new series is addressed to Government officials, corporate executives, representatives of non-governmental organizations, officials of international agencies and researchers.

The *Series* seeks to provide a balanced analysis of issues that may arise in the context of international approaches to investment rulemaking, and their impact on development. Its purpose is to contribute to a better understanding of difficult technical issues and their interaction, and of innovative ideas that could contribute to an increase in the development dimension of international investment agreements.

The *Series* is produced by a team led by James Zhan. The members of the team include Bekele Amare, Anna Joubin-Bret, Hamed El-Kady, Joachim Karl, Jan Knoerich, Ventzislav Kotetzov, Marie-Estelle Rey, Elisabeth Tuerk and Jörg Weber. Members of the Review Committee are John Kline, Peter Muchlinski, Antonio Parra, Patrick Robinson, Karl P. Sauvant, Pierre Sauvé, M. Sornarajah and Kenneth Vandavelde.

This paper was prepared by Joachim Karl. Amare Bekele, Hamed El-Kady, Michael Gindler, Elisabeth Tuerk and Jörg Weber made substantial contributions. Comments were received from Gabriel Bottini, Rudolf Dolzer, Anna Joubin-Bret, Patrick Robinson, Ignacio Torterola and James Zhan. Research assistance was provided by Sandra Boigontier and desktop publishing was done by Teresita Ventura.

This paper provides a timely discussion of a crucial issue related to the development dimension of IIAs, in line with the implementation of UNCTAD's renewed mandate in the area of international investment agreements emanating from the Accra Accord (paragraph 151).

Supachai Panitchpakdi  
Secretary-General of UNCTAD

March 2009



---



---

## CONTENTS

PREFACE .....	v
EXECUTIVE SUMMARY.....	xiv
INTRODUCTION .....	1
<b>I. EXPLANATION OF THE ISSUE .....</b>	<b>7</b>
<b>A. The evolving concept of national security – from countering military threats to tackling economic crisis and protecting strategic industries .....</b>	<b>7</b>
1. Economic crisis .....	8
2. Protection of strategic industries .....	10
(a) <i>Definition of “strategic industries”</i> .....	15
(b) <i>Against whom is protection sought?</i> .....	17
(c) <i>Threshold for invoking national security interests</i> .....	24
<b>B. The role of IIAs .....</b>	<b>25</b>
1. The need to balance conflicting interests.....	25
2. The distinction between the pre- and the post-establishment phases of an investment .....	27
3. National security interests and the “denial of benefits” clause .....	32
4. IIAs and customary international law.....	34
<b>C. Main policy issues concerning the protection of national security interests .....</b>	<b>37</b>
1. The degree of autonomy of Contracting Parties in invoking a security-related exception .....	38



2.	The effects of a security-related exception .....	43
3.	Sovereign wealth funds as protected investors.....	43
<b>D.</b>	<b>International jurisprudence and national security .....</b>	<b>44</b>
1.	International Centre for Settlement of Investment Disputes (ICSID).....	45
(a)	<i>Relationship between the treaty exception and the necessity defence under customary international law</i> .....	46
(b)	<i>Economic crisis covered by the exception clause</i> .....	49
(c)	<i>Self-judging exception?</i> .....	49
(d)	<i>Compensation</i> .....	50
2.	World Trade Organization/General Agreement on Tariffs and Trade.....	51
(a)	<i>Interpretation of “public morals” and “public order”</i> .....	52
(b)	<i>Necessity of the measure</i> .....	53
(c)	<i>Self-judging nature</i> .....	54
3.	European Court of Justice .....	56
4.	North American Free Trade Agreement (NAFTA).....	59
5.	Conclusion.....	59
<b>II.</b>	<b>STOCKTAKING AND ANALYSIS .....</b>	<b>71</b>
<b>A.</b>	<b>The use of the term “essential security interests”, and related terms used in IIAs .....</b>	<b>72</b>
1.	“Essential security interests” and “national security” .....	72
2.	Other terms used .....	74
<b>B.</b>	<b>Conditions for invoking a security-related exception in IIAs .....</b>	<b>81</b>
1.	No arbitrary or unjustifiable discrimination.....	81
2.	Disguised restriction of investment or trade.....	83
3.	Listing of cases in which there may be a threat to “essential security interests” .....	85
4.	Conformity with other international rules.....	89
5.	Necessity of the host country response .....	90
(a)	<i>Self-judging clauses</i> .....	91

(b) <i>Necessity as objective precondition</i> .....	92
(c) <i>No reference to “necessity”</i> .....	94
(d) <i>Exclusion of judicial review</i> .....	95
<b>C. Security-related exceptions in relation to specific IIA provisions</b> .....	<b>96</b>
1. Specific exception clause as an alternative to a general clause .....	96
2. Specific security exception in addition to a general clause .....	102
<b>D. Non-applicability of a security-related exception with regard to individual IIA provisions</b> .....	<b>105</b>
<b>III. INTERACTION WITH OTHER ISSUES AND CONCEPTS</b> .....	<b>111</b>
<b>IV. POLICY OPTIONS IN RESPECT OF THE PROTECTION OF NATIONAL SECURITY IN IIAS</b> .....	<b>119</b>
<b>A. No exception related to national security</b> .....	<b>119</b>
<b>B. Clarification of the term “essential security interests”</b> ..	<b>121</b>
<b>C. Necessity of the host country response</b> .....	<b>125</b>
1. Self-judging clause .....	125
2. Non-self-judging clause .....	127
<b>D. Additional means of limiting the scope of application of a security-related exception</b> .....	<b>129</b>
1. Introducing a “good faith” requirement .....	129
2. National security exception only in respect of certain IIA provisions .....	130
3. Non-applicability of the national security exception	

---

in respect of certain IIA provisions.....	131
4. Periodic review of the measure .....	132
<b>CONCLUSION.....</b>	<b>135</b>
<b>REFERENCES .....</b>	<b>139</b>
<b>SELECTED UNCTAD PUBLICATIONS ON TRANSNATIONAL CORPORATIONS AND FOREIGN DIRECT INVESTMENTS .....</b>	<b>143</b>
<b>QUESTIONNAIRE.....</b>	<b>155</b>

### Boxes

Box 1. Recent foreign takeovers plans affected by perceived essential security interests.....	17
Box 2. OECD guidelines on investment policies relating to national security.....	22

### Tables

Table 1. Interaction across issues and concepts.....	111
Table 2. Options for security-related IIA exceptions .....	122

## ABBREVIATIONS

<b>ASEAN</b>	Association of Southeast Asian Nations
<b>BIT</b>	Bilateral investment treaty
<b>CNOOC</b>	China National Offshore Oil Corporation
<b>EC</b>	European Community
<b>ECJ</b>	European Court of Justice
<b>ECOWAS</b>	Economic Community of West African States
<b>EFTA</b>	European Free Trade Association
<b>EU</b>	European Union
<b>FDI</b>	Foreign direct investment
<b>FTA</b>	Free trade agreement
<b>GATS</b>	General Agreement on Trade in Services
<b>GATT</b>	General Agreement on Tariffs and Trade
<b>ICSID</b>	International Centre for Settlement of Investment Disputes
<b>IIA</b>	International investment agreement
<b>ICJ</b>	International Court of Justice
<b>ILC</b>	International Law Commission
<b>IMF</b>	International Monetary Fund
<b>NAFTA</b>	North American Free Trade Agreement
<b>OECD</b>	Organization for Economic Cooperation and Development
<b>SWF</b>	Sovereign wealth fund
<b>UNCTAD</b>	United Nations Conference on Trade and Development
<b>WTO</b>	World Trade Organization



## EXECUTIVE SUMMARY

After almost two decades of nearly unequivocal support for investment liberalization, many countries have started to re-evaluate these policies, and some have introduced adjustments, thereby exercising their right to regulate foreign investment to pursue domestic policy objectives. One of the main areas where a more restrictive approach towards foreign investment has become manifest relates to national security, and to the protection of strategic industries and critical infrastructure.<sup>1</sup> While national security concerns in relation to foreign investment are nothing new and must be an issue even for the most liberal country, cases have become more frequent in recent years where foreign investors have been rejected for national security reasons or subjected to other restrictive measures after establishment. Most often, security concerns have been invoked in relation to planned investments in so-called strategic industries and critical infrastructure. Thus, the issue has implications that go far beyond the defence-related activities for which the national security exception was initially designed.

Several reasons may explain this development.

- Firstly, actual or perceived threats to national security have become more numerous. Although the Cold War has ended, there are now many more local and regional conflicts, as well as terrorist attacks that can strike seemingly at random. All this has substantially augmented the global threat perception. Foreign investment policies cannot ignore these developments, since there may be more occasions where an investor comes from a country that is considered as an actual or potential adversary, or where the investors themselves are perceived as a potential security threat.

- Secondly, the huge wave of privatization in the last decades has had the unexpected result that many countries now feel more exposed to security risks than in the past. Obviously, foreign control over vital domestic industries – such as energy, telecommunications, transportation or water – is perceived to have possible implications for national security. As long as these strategic industries were under State ownership, Governments did not have to worry that they could fall under foreign influence. With considerable parts of these industries privatized in many countries, the option of foreign takeovers has become real.
- Thirdly, some countries see a need to exercise a stronger control over their natural resources. Consequently, they have introduced new restrictions for foreign investors in the extractive industries or have demanded the renegotiation of existing investment contracts. Often, national security considerations have played an important part in these policies.
- Fourthly, countries may be of the opinion that domestic ownership or control of strategic industries is important for their competitiveness. For developing countries, the issue of competitiveness also has an important development dimension. Since an erosion of economic competitiveness and a lack of economic and social development can result in severe financial and social crisis, there is a link to national security concerns in respect of foreign investment.
- Fifthly, the spread and the more active role of State-owned enterprises and sovereign wealth funds (SWFs) – especially from the South – have further accentuated national security concerns in relation to foreign investment. There are fears that their considerable financial power could put them in a position to buy up any industry they like. In addition, in view of the State ownership of these firms and funds, it has

been argued that they would not only pursue economic goals but also political objectives.

Apart from the issue of strategic industries, national security interests have in recent years also been invoked in connection with economic crisis. This was the case, in particular, during the crisis in Argentina at the beginning of this century. In order to fight the crisis, the Argentinian Government took a number of measures that restricted the operations of foreign investors, such as transfer restrictions. These measures, therefore, affected already established investors in the country; whereas investment restrictions to protect strategic industries usually affect the entry of foreign investors. Argentina argued that these measures were required to protect its internal security interests in the face of domestic upheavals and extended social tensions. Since a severe economic crisis can hit any country – and developing countries in particular – the issue is in no way limited to the situation that prevailed in Argentina.

An important difference between national security interests in respect of strategic industries on the one hand, and with regard to economic crisis on the other hand, is that measures taken by host countries usually have a precautionary character in the former case, and a reactive nature in the latter. Governments take action to protect strategic industries before any damage has occurred. By contrast, a country must already be in a state of economic crisis before measures based on national security considerations can be taken.

Looking at it from a host-country perspective, national security interests are thus important both for developed and developing countries. Developed countries have been the most prominent in referring to their national security interests in relation to attempted foreign takeovers of their strategic industries. Developing countries, in particular, may feel a need to do this in times of economic crisis.



This leads to the issue of the role of international investment agreements (IIAs) in connection with investment restrictions based on national security considerations. By establishing obligations on Contracting Parties concerning the treatment of foreign investors, IIAs impose certain limits on the sovereign right of each country to regulate foreign investment in its territory, including its regulations in the area of national security. There is, therefore, a potential conflict between the objective of investment protection on the one hand, and addressing the Contracting Parties' security concerns on the other. However, numerous IIAs expressly dispense Contracting Parties from all or parts of their treaty obligations in cases where an investment poses a threat to national security. Thus, the challenge for Governments is to find an appropriate balance – ensuring a sufficient level of protection for its national security interests, while at the same time ensuring that investment protection is still strong enough to keep the country attractive for foreign investors.

The challenge of balancing rights and obligations as well as the interests of foreign investors and host countries becomes more pressing as policies aimed at protecting strategic industries gain momentum. As more and more countries justify the protection of these companies by invoking national security considerations, IIA security exceptions that were originally perceived as targeting military threats and related matters are receiving a new dimension and broadening their scope of application considerably. Likewise, the global economic crisis has struck many developing countries – to different degrees – and nobody can rule out the possibility that this will escalate into an emergency situation in a growing number of them. On top of this, a security exception may have a huge effect – namely that of freeing the Contracting Party from all its obligations under the IIA.

All of this has important implications. Firstly, countries that have concluded IIAs that do not contain a national security exception may feel the need to have one, in order to safeguard their

regulatory freedom with regard to strategic industries, or in the face of economic crisis. Secondly, countries that agreed upon a national security exception in the IIA may ask themselves whether it is broad enough to cover restrictions on foreign investment in order to protect strategic industries or to tackle the economic crisis. On the other hand, foreign investors and their home countries might have exactly the opposite concern. They may have thought that the scope of a national security exception would be limited to defence-related matters, whereas they may now be confronted with a situation where the clause has much larger and unexpected effects. Thirdly, there is the question as to whether these new developments require adjustments in IIAs as regards the conditions under which the exception may be invoked. It seems plausible that Contracting Parties may retain more discretion in reacting to a threat to national security if a military threat or another kind of emergency situation is at stake, than in cases involving political, economic and competitive interests in connection with the protection of strategic industries where there is no actual crisis situation.

The review undertaken for this study suggests that up to now, only a minority of IIAs contain some kind of national security exception, and that such clauses are more frequent in agreements covering the entry of foreign investment than in treaties limited to the post-establishment phase. This can be explained by the fact that national security concerns in connection with foreign investment primarily arise with regard to the admission issue.

Countries have adopted a variety of approaches concerning the drafting of a national security exception in IIAs. Differences exist with regard to the term used (e.g. national security, essential security interests, international peace and security, or public order), the conditions under which the exception can be invoked, and the degree of autonomy that Contracting Parties reserve for themselves in assessing whether a threat to national security exists

and how to respond to it. Countries considering a national security exception in IIAs therefore face a number of critical choices.

As far as the wording and the conditions of application of the clause are concerned, it is difficult to identify a predominant trend. Much depends on how broadly or narrowly the Contracting Parties interpret “national security” and related terms in their domestic legal order, and whether they seek protection primarily against “classic” risks to national security, or in a wider sense. In this context, it is important to note that the move towards stronger protection of strategic industries at the national level has not (yet) translated into an IIA policy of seeking an explicit exception in this respect. One explanation for this situation could be that most IIAs do not establish any obligations with regard to the entry of foreign investors, whereas – as has already been explained – the protection of strategic industries is primarily an admission issue. Another explanation could be that IIA Contracting Parties either do not wish such an exception, or that they consider a “normal” national security clause sufficient to also cover strategic industries. By contrast, various IIAs explicitly mention protection of the public order or serious internal disturbances, which appears to cover situations of severe economic crisis.

Likewise, it is difficult to discern a main pattern with regard to the second crucial issue – that of whether the national security exception should be self-judging or not. Obviously, the first alternative gives Contracting Parties more discretion in the application of the clause – an approach which might not be the most appropriate one when it comes to the protection of strategic industries. However, as will be explained in section I.C.1, the differences between the two options might be less pronounced in practice than it appears at first sight.

Closely related to the issue of a national security exception is the so-called “denial of benefits” clause that can be found in some IIAs. Such a clause usually gives the Contracting Parties the right

to deny the benefits of the treaty to an investment if investors of a third State, with which the denying Contracting Party does not maintain diplomatic relations, control the investment. Such a clause may, therefore, also be used to deny foreign investors access to strategically sensitive industries, although the conditions for doing so – the absence of diplomatic relations with the home State of the controlling investor – are far more restricted than in the case of a national security clause.

In light of recent developments, IIA negotiators may wish to pay more attention to the possible coverage of strategic industries and economic crisis in national security exceptions and related concepts. They have to ask themselves whether they see a need for a broad and undefined security exception that gives them maximum discretion, or whether they prefer a more limited clause in the interests of better legal security and predictability. In the latter case, IIA Contracting Parties have various options to clarify the scope and conditions under which a national security exception applies. Among them is to give more precision to the term “national security” and the situations in which the exception clause should apply. Also, one could consider additional preconditions for invoking the exception, such as an explicit good faith requirement concerning the use of the clause, and a periodic review of the continuous need to uphold the security-related investment restriction. All these options help to prevent the subject of national security exceptions in IIAs from becoming a “black and white” matter, and allow more differentiated solutions to be adopted, permitting a fair balance between the interests of the Contracting Parties and the foreign investors.

### Note

- 
- <sup>1</sup> A distinction can be made between “strategic industries” and “critical infrastructure”. Whereas the former term relates to all industries that a government considers as crucial for its economic development, the latter term is limited to the infrastructure sector, and is not only relevant for economic reasons, but also for the well-being of society (e.g. access to water and sanitation). While the two terms are therefore not identical, this paper nevertheless uses the term “strategic industries” for both alternatives, in order to provide for an “easier” reading.



## INTRODUCTION

Recently, a tendency has emerged to invoke national security considerations in an economic context. A number of recent arbitration awards in connection with Argentina's economic crisis in the early years of the new millennium dealt with the issue of whether this situation constituted a threat to the country's national security and therefore justified restrictions being imposed on foreign investors.<sup>1</sup> Severe economic or financial crisis can potentially hit any country. Developing countries are particularly at risk, as many examples from the past and present demonstrate. Most recently, the current food and energy crises have caused riots and other forms of violence in many places. It is therefore possible that in the future even more countries will feel compelled to take emergency measures, and that these actions will include restrictions on foreign investment.

As important as such emergency actions may appear from the host country's point of view, they may cause considerable damage for foreign investors and have a very negative impact on the investment climate. They might even further aggravate the crisis, at least in the short term, if much-needed foreign capital flees the country and fresh money stops coming. Thus, emergency measures in times of economic crisis can be a mixed blessing, and avoiding excessive reactions from the government's side could be crucial.

Also, a growing number of countries is showing reluctance to or even opposing allowing foreign investors to acquire companies that are considered to be of strategic importance. Often, a mixture of political and economic considerations is at the root of such policies – for instance the wish to keep control over domestic natural resources and critical infrastructure, or the belief that foreign ownership could undermine government efforts to enhance a country's competitiveness and development prospects. In particular, investments by foreign sovereign wealth funds, and the

potential risk that their investment decisions might not be free from political considerations, have led to demands for a stricter control of their activities. In some cases, these concerns have not only affected the making of new investments in the host country, but have also resulted in the forced disinvestment of existing investments or in amendments to their terms of operation.

Significant changes that occur in the patterns of international investment flows might further reinforce these trends. As emerging economies turn into powerful economic and political players, they also invest more in foreign countries. Investment flows that were once a one-way street from developed countries to developing countries increasingly become busy two-lane roads. This marks the beginning of a new phase of globalization in which investors from emerging economies (such as Brazil, China, India, the Russian Federation and South Africa) play a growing role.

How will developed countries react to these power changes? Will they unconditionally welcome substantially more investment from emerging economies, or will they adopt a more restrictive attitude? In particular where investment by sovereign wealth funds is concerned, recent developments in various developed countries have shown a mixed picture. Although developed countries, in general, have so far remained open to such investment, one cannot rule out the possibility that they may become more defensive in light of the economic crisis and its aftermath. Indeed, protectionist tendencies are already visible, and they may increase even further when the global economy is recovering and public funds begin to exit from flagship companies bailed out during the crisis. As the economic and financial strength of SWFs increases, they may seek control over strategic companies in which they hold stakes. As a result, there is a risk that a mixture of political arguments and psychology may override economic reasoning.



---

There is also a more serious risk involved. If the defence of strategic industries becomes more widespread amongst countries, this could have severe effects on economic growth, hinder an optimal resource allocation, and result in significant investment distortion. The economic consequences might be all the more serious in view of the fact that in most countries, strategic sectors are amongst the most significant and most valuable sectors – not only from the point of view of the host country, but often also from the perspective of the investor’s home country. If the latter is barred from making an investment abroad, this may also severely affect the home country’s development strategies.<sup>2</sup>

Undoubtedly, it is the sovereign right of host countries to regulate foreign investment, and this includes the option to impose restrictions for national security reasons. It is also up to host countries to decide how they define “national security”, and under what circumstances they consider this interest to be at risk. This gives them huge discretion in deciding whether a particular foreign investment threatens their national security or not, and how to respond. On the other hand, a foreign company considering making an investment abroad seeks legal assurance and clarity concerning the investment conditions in the host country. Therefore, a foreign investment policy of host countries based on a vague national security concept may have a discouraging effect on foreign investors, irrespective of whether it would actually apply in an individual case.

This paper explores what role IIAs play in this context, and what approaches these treaties have taken with regard to national security exceptions. Such exceptions are included in the majority of recent free trade agreements (FTAs) with investment provisions, and in 12 per cent of the bilateral investment agreements (BITs) reviewed.<sup>3</sup> The issue of national security may become more important in future IIA negotiations, since the number of States either introducing or considering introducing national laws aimed at restricting foreign ownership for national

security reasons and at securing greater government control over strategic sectors, such as natural resources and the extractive industries, is increasing (UNCTAD, 2008).

IIAs set certain limits for the Contracting Parties to regulate foreign investment in their territory. This means that they might also limit a country's right to restrict foreign investment for national security reasons. However, to the extent that IIAs include such an exception, the constraints imposed upon governments by IIAs might no longer apply. Therefore, policymakers and foreign investors alike need to know about the various interactions between national security policies, the conclusion of IIAs, and national security exceptions in the investment treaty.

Obviously, there is a potential conflict between these treaties' overall objective of promoting and protecting foreign investment, and the legitimate desire of host countries to safeguard their national security interests. A discussion about the "right" balance between these potentially differing goals in IIAs becomes all the more important as the protection of strategic industries and also the emergency measures taken in times of economic crisis add significant new elements to the potential meaning of "national security", and might therefore shift the equilibrium in favour of more State sovereignty at the expense of investment protection.

In exploring the role of IIAs in this context, the paper seeks to address the following questions:

- To what extent do IIAs include specific rules on national security?
- What concept of "national security" do IIAs use?
- What approach do IIAs take with regard to the right of Contracting Parties to invoke a national security exception?

- 
- 
- How far-reaching are the legal effects of a national security exception?
  - What options do IIA negotiators who are considering a national security exception have, and would it be useful to distinguish between different kinds of security threats?
  - What is the role of international arbitration in this context, and in particular, what interpretation have arbitration tribunals given to the concept of national security?

The paper is structured along the lines established by UNCTAD's series on issues in international investment agreements,<sup>4</sup> as follows:

- Explanation of the issue of national security in the context of IIAs, including a survey of recent developments in national legislation and administrative decisions;
- Survey of national security exceptions in IIAs, such as bilateral investment treaties, and regional and free trade agreements;
- Interaction of national security exceptions with other issues and concepts in IIAs;
- Options for IIA negotiators concerning national security exceptions in IIAs.

### Notes

---

<sup>1</sup> See section I.D.1.

<sup>2</sup> For a discussion, see UNCTAD (2006).

<sup>3</sup> Security-related exceptions appear consistently in the BITs concluded by Germany, India, Belgium-Luxembourg, Canada, the United States, and to a lesser degree, Mexico. Sometimes, these exceptions appear under a different name, such as “essential security interests” or “public order”. All IIAs mentioned in this paper can be found at <http://www.unctad.org/iaa>.

<sup>4</sup> See <http://www.unctad.org/Templates/Page.asp?intItemID=2322&lang=1>

## I. EXPLANATION OF THE ISSUE

Four basic questions come to mind when discussing the issue of a national security exception in IIAs:

- A. What is the focus of the current debate about foreign investment and national security?
- B. What role do IIAs play in this discussion?
- C. What are the main policy issues when negotiating a national security exception in IIAs?
- D. How has international jurisprudence developed in this area?

### **A. The evolving concept of national security – from countering military threats to tackling economic crisis and protecting strategic industries**

The concept of “national security” is broad and potentially ambiguous. The Oxford English Dictionary defines the term as the “safety of a nation and its people, institutions, etc., especially from military threat or from espionage, terrorism, etc.” This definition is neither exhaustive concerning the object of protection nor concerning the origin of the threat. Thus, while the safety of the nation and its people is clearly at the core of the provision, one could reasonably argue that threats to the health of the population or the environment are covered too, as well as threats to the general political, economic and financial system of a country, including the domestic infrastructure and cultural traditions. Likewise, there may be a variety of causes for a threat to the national security. In addition to the above-mentioned examples of a military threat, espionage and terrorism risks may emerge too, for instance in connection with the spreading of diseases, natural disasters, civil strife, severe economic crises or attempted foreign control of vital national industries. The evolving concept of

national security also implies that new threats to national security may arise in the future that are unknown today.

### 1. Economic crisis

Two important issues have emerged in recent years related to national security concerns in respect of foreign investment. One has to do with the relationship between economic crisis and national security. A number of recent investment disputes have addressed the question of whether Argentina's economic crisis at the beginning of the new millennium amounted to a threat to the country's national security and whether this could be a valid defence against investor allegations that Argentina had violated its obligations in its BIT with the United States of America.<sup>1</sup>

All of the tribunals concurred in the view that article 11 of the BIT encompassed economic emergencies and thus did not only relate to military and political threats. For example, the *CMS* tribunal stated that there was "nothing in the context of customary international law or the object and purpose of the Treaty that could on its own exclude major economic crises from the scope of article 11."<sup>2</sup> Furthermore, "if the concept of essential security interests were to be limited to immediate political and national security concerns, particularly of an international character, and were to exclude other interests, for example, major economic emergencies, it could well result in an unbalanced understanding of article 11."<sup>3</sup>

Also, the *LG&E* tribunal rejected the notion that article 11 was only applicable in circumstances amounting to military action and war. In its opinion, to conclude that a severe economic crisis could not constitute a national security issue was "to diminish the havoc that the economy can wreak on the lives of an entire population and the ability of the Government to lead."<sup>4</sup> In the *Continental Casualty* case, the tribunal recalled that "international law is not blind on the requirement that States should be able to exercise their sovereignty in the interest of their population free

from internal as well external threats to their security and the maintenance of a peaceful domestic order.”<sup>5</sup> When a State’s economic foundation was under siege, the severity of the impact could potentially equal that of any military invasion. Thus, albeit using different interpretative approaches, the tribunals came to the same conclusion, i.e. that the term “essential security interests” in principle also covers severe economic crises.

Despite this outcome, the tribunals did, however, deviate with regard to their assessment of the level of severity of the Argentinian economic crisis. Whereas the *CMS* Tribunal stated that “the Argentine crisis was severe but did not result in total economic and social collapse”,<sup>6</sup> the *LG&E* tribunal found that “from 1 December 2001 until 26 April 2003, Argentina was in a period of crisis during which it was necessary to enact measures to maintain public order and protect its essential security interests”.<sup>7</sup> The *Continental Casualty* tribunal, without delimiting the period of crisis, concluded that the invocation of the national security clause “does not require that the situation has already generated into one that calls for the suspension of constitutional guarantees and fundamental liberties”.<sup>8</sup>

For the tribunal in the *CMS* case, only an economic crisis imperilling a State’s existence would be of a sufficient scale to fulfil the requirements of article 11 of the BIT. It denied that such a situation existed. Similarly, the tribunals in the *Enron* and *Sempra* cases found the Argentinian crisis to be severe. Yet, they too held that the argument that “such a situation compromised the very existence of the State and its independence so as to qualify as involving an essential interest of the State was not convincing”.<sup>9</sup>

In contrast, the *LG&E* tribunal looked at major economic indicators and concluded that all of these devastating conditions – economic, political and social – in the aggregate triggered the protections afforded under article 11 of the Treaty to maintain order and control the civil unrest.<sup>10</sup> It found that “extremely severe crises in the economic, political and social sectors reached their

apex and converged in December 2001, threatening the total collapse of the Government and the Argentine State”.<sup>11</sup> Similarly, the *Continental Casualty* tribunal came to the assessment that the crisis brought about the “sudden and chaotic abandonment of the cardinal tenet of the country’s economic life”.<sup>12</sup> Thus, the tribunals differed in their interpretation of the factual basis of the case.

In conclusion, if an IIA contains a national security exception, Contracting Parties can be relatively sure that in the case of economic crisis, this clause is, in principle, applicable. However, they can be much less sure about the degree of severity that the crisis must have in order for the national security exception to be pertinent. This might have implications for the drafting of a national security exception in future IIAs.<sup>13</sup>

## **2. Protection of strategic industries**

The second issue relates to national security concerns in connection with foreign control over domestic sectors and industries considered by the host country as having strategic importance. Cases where foreign companies have been rejected or been subject to other restrictions because they attempted to invest in strategically important industries are nowadays much more frequent than those where access has been denied for reasons of national security as defined in a narrow sense (see box 1). In most cases, these measures have made it more difficult for foreign investors to operate. Such measures include new restrictions on foreign ownership, the nationalization of oil and other sensitive sectors, the renegotiation of concession contracts with foreign investors, and the introduction of new lists of sectors in which inward foreign direct investment (FDI) would be restricted.



**Box 1. Recent foreign takeover plans affected by perceived national security interests**

The number of cases where governments have blocked foreign investments in key domestic industries for national security reasons has increased in recent years. Concerns were especially strong when bidding companies had close ties with their home-country governments. Industries that were affected the most included oil, gas and other mining, information and communication technology, and other infrastructure services (UNCTAD, 2006). The following are some examples:

One of the first cases that received much attention concerned the China National Offshore Oil Corporation (CNOOC), the Chinese State-owned oil company that announced a takeover of Unocal, the ninth-largest oil firm in the United States, in 2005. The proposed takeover triggered concerns relating to national security, alleged unfair competition, and the risk of technology leakage. After intervention from the United States Congress, CNOOC withdrew its bid, and Unocal eventually merged with the United States-based Chevron Corporation (UNCTAD, 2006).

In March 2006, the United States Congress blocked the proposed \$6.8 billion takeover by Dubai Ports World of a British company, Peninsular and Oriental (P&O). The proposed deal would have brought six United States ports – including those of New York and Philadelphia – under its management (Singh, 2007).

In Europe, the Spanish Government successfully prevented a takeover of the energy supplier Endesa by the German provider E.ON in 2005. In a similar move, the French Government resisted the acquisition of Suez by the Italian firm ENEL. This was achieved by promoting the merger of Gaz de France and Suez, thereby creating a “national champion”.

/...

**Box 1. Recent foreign takeover plans affected by perceived national security interests (continued)**

Mittal Steel's \$22.7 billion takeover bid for the Luxembourg-based Arcelor in 2005 faced stiff political resistance from the Governments of France, Luxembourg and Spain. Registered in Luxembourg, Arcelor is a European steel company created by the merger in 2001 of Aceralia (from Spain), Usinor (from France) and Arbed (from Luxembourg). Since the offer made by Mittal Steel was financially lucrative, the majority of Arcelor shareholders ignored government concerns and approved the takeover in June 2006 (Singh, 2007).

Security concerns about foreign investment have also been raised in some emerging markets. China, for instance, has stepped up scrutiny of foreign takeovers of some strategic domestic enterprises (Sauvant, 2006). National security concerns have been raised lately with regard to industries that would not universally be seen as security risks. For example, security concerns were behind the decision of the Government of India to block a bid in November 2005 by a subsidiary of Hutchison Whampoa from Hong Kong (China) for a container terminal in Mumbai (UNCTAD, 2006).

Foreign investment in the energy sector – in particular oil and gas – has been especially exposed to national security concerns during the last few years. Several countries have introduced new restrictions for foreign investment or otherwise sought to change the contractual terms of operations for those companies. For instance, foreign oil companies in the Russian Federation had to cede control of a number of major projects that they had acquired in the 1990s. Most notable were the sale by Royal Dutch Shell of a controlling stake in the Sakhalin-2 project, and British Petroleum's sale of its stake in the Kovykta gas field. In both cases, the Russian State-run natural gas monopoly Gazprom was the buyer.

/...

**Box 1. Recent foreign takeover plans affected by perceived national security interests (concluded)**

Several Latin American countries have renegotiated investment contracts with foreign investors in strategic sectors, with the goal of achieving a better economic equilibrium between the foreign company and the host country. In Bolivia, all foreign transnational oil corporations agreed to convert their production-sharing contracts into operating contracts, and to turn control over sales to Yacimientos Petrolíferos Fiscales Bolivianos, Bolivia's state-run oil company, as stipulated in the decree for nationalization of oil and gas resources of May 2006. In addition, the Government reached a deal in 2007 with Petrobras (Brazil) to renationalize the company's two oil refineries that had been acquired by Petrobras in 1999. The Government is also moving to take over Empresa Nacional de Telecomunicaciones (Entel) – currently controlled by Telecom Italia – which was nationalized in 1996 (UNCTAD, 2007a). In Ecuador, a new law was passed on 1 May 2006, allotting to the Government a 60 per cent tax on the oil profits of foreign companies, if the oil price exceeds certain benchmarks (Singh, 2007). In 2007, the Bolivarian Republic of Venezuela adopted a decree that gave the State-owned company PDVSA a majority equity share and optional control of four joint ventures in the oil-rich Orinoco river basin. The Bolivarian Republic of Venezuela also assumed State control of other industries, such as telecommunications, electricity and non-fuel mining. In the case of non-fuel mining, the national assembly approved a bill in 2006 to reform the mining law (UNCTAD 2007a).

*Source:* UNCTAD.

While the terms used to identify those activities may differ – one may speak, for instance, of “strategic infrastructure”, “vital industries” or “national champions” – the purpose is always similar: to be able to prevent foreign companies from investing in sectors considered to be of critical importance for a society, or – if such

investment has already taken place – to have the right to terminate such investment and to subject it to other restrictions.<sup>14</sup>

There are several reasons why the protection of strategic industries has attracted so much attention. One has to do with privatization. As long as strategic enterprises – such as those in the infrastructure sector – were State-owned, there was no risk that they could fall under foreign control. Private investors, whether domestic or foreign, simply did not have the right to invest in these activities. With privatization extending to strategic industries in many countries, foreign investors nowadays have the possibility of acquiring shares in them. In many countries, however, the voices that say that this should not be permitted are getting louder, or at least they are saying that there should be some safeguards to control foreign influence in these enterprises.

Furthermore, there is dissatisfaction in numerous developing countries about privatization deals that have been concluded in the past. Complaints have been made that privatization contracts were too favourable to the foreign investors, and that their renegotiation would be necessary in order to achieve a fair balance of interests. In most cases, these investment contracts concern strategic industries, such as energy or the water supply.<sup>15</sup>

In addition, the recent trend of rising global demand for energy and other commodities has confirmed the great importance of these industries as a means for the home countries to generate substantial income and to enhance their overall economic and political weight. Despite the current downturn in demand, it is no surprise that these countries are keener than ever to assert their control over these vital industries, and that they consider such control as being of national interest.

The following issues are particularly relevant in the current debate:

---

*(a) Definition of “strategic industries”*

In the absence of an international consensus on the meaning and scope of this term, every country defines on its own what it understands by “strategic” enterprises or industries. Whereas a number of international conventions have tried to clarify the term “national security”, no similar clarification exists for the term “strategic industries”. Often, a clear distinction between the two concepts is missing, i.e. countries protect strategic industries because they regard this as necessary for their national security. As a result, there is much uncertainty about the conditions under which the national laws of host countries allow for blocking the entry of foreign investors or otherwise interfering with their business.

A potentially broad spectrum of industries may be considered as “strategically important”. One important category is the domestic infrastructure, including telecommunications, transportation, energy, and the water supply. Agriculture may be another sector that a country considers to be crucial for its survival. In addition, there may be specific industries in individual countries that have such great importance for the domestic economy that the country in question considers them to be strategically significant. For instance, a country may rely on one specific sector or even one individual company for the generation of foreign exchange, or it may regard another sector as crucial for further technological development.

Host countries and foreign investors have potentially divergent interests concerning the definition of “strategic” industries. Host countries might favour a relatively broad concept that leaves the government with sufficient discretion in designating strategic sectors, including the possibility of adding or deleting individual activities to the list. By contrast, foreign investors are more likely to have an interest in a definition of “strategic” sectors – if this cannot be avoided altogether – that is as narrow as

possible, and in the establishment of clear criteria to assess whether a company is of “strategic” importance or not.

Two basic concepts concerning the definition of industries that are sensitive for national security reasons or have strategic importance can be distinguished at the national level. One approach is to leave these terms basically undefined, thereby giving maximum discretion to the national authorities in applying the concept in a concrete case. At the other end of the spectrum is a method whereby a country establishes an exhaustive list of industries or activities that it considers relevant under national security concerns. Obviously, the latter technique is much more transparent and provides much more clarity. At the same time, however, the amount of room for manoeuvre that a government has under this option is narrower too (see also section IV.C).

Differences in State practice also exist with regard to important procedural issues. Whereas in some countries foreign companies are obliged to ask for permission for a planned investment, other countries leave it to the discretion of the foreign enterprise whether that enterprise wants to inform the domestic authorities of the intended acquisition. However, the host country has the right to retrospectively deny authorization for the acquisition if such information has not been given prior to the investment.

The need to protect strategic industries is felt by many countries, irrespective of their level of development. With regard to the protection of strategic enterprises, one might assume that such policies would primarily be pursued by developing countries as an interventionist instrument used to promote national champions and to advance their development objectives. However, an increasing number of developed countries are following a similar path. Actually, most of the recent debate about national security concerns in respect of foreign investment and the perceived need to protect strategic companies has taken place in countries of the

---

Organization for Economic Cooperation and Development (OECD), and not in the developing world (see also section I.A.4).

With the role of emerging economies as capital exporters likely to undergo further substantial increase in the coming years, one can expect that this debate will gain still more momentum. Developed countries need to adapt to profound changes in the process of globalization whereby their transnational corporations are no longer the exclusive global players in the area of foreign investment. More and more enterprises from developing countries are attaining the capacity to make substantial investments abroad and to compete successfully with their counterparts from OECD countries, although the total amount of foreign investment by developing countries is currently still small compared to that of developed countries.<sup>16</sup>

Demands in developed countries for the protection of their strategic industries are a primarily defensive response to these landmark changes. It remains to be seen whether these demands will become still stronger in the future, or whether there will be a return to more laissez-faire policies once the current adaptation phase and global economic crisis have come to an end.

*(b) Against whom is protection sought?*

- *The nationality of the foreign investor*

While the mere fact that the investor comes from a foreign country might already be enough to raise some national security concerns, these concerns might be particularly strong if the investor holds the nationality of a country that is perceived as hostile or with which political relations are otherwise unfriendly. For instance, it is unlikely that a host country would allow the acquisition of a domestic high-tech company if there were a risk that the foreign investor – and its home country – might exploit such technology to develop weapons or other military-related

material that could be used against it. By contrast, such fears might not exist if the investor came from a country with which the host country enjoyed good relations or which was even a military ally.

Similar concerns might exist with regard to investments in strategic enterprises, including the host country's infrastructure. The host country might not wish vital parts of its economy (e.g. transportation, telecommunications, energy, or water) to fall into the hands of foreigners, if it feared that the foreigners might one day misuse their control over these assets in a hostile manner.

However, host countries may already be inclined to reject foreign investment in these sectors for less dramatic reasons. National pride may already be enough to refuse the involvement of any foreign investor in domestic "flagship" companies. Host countries may wish to keep such enterprises free from foreign influence, even if the investor comes from a friendly country.

- *Sovereign wealth funds*

Much of the recent debate concerning the defence of strategic industries has arisen in connection with sovereign wealth funds (SWFs). This may be explained by the fact that these funds have gained considerable importance in recent years. However, sovereign wealth funds are not a new phenomenon. An early example is the French "Caisse des dépôts et consignations" founded in 1816. A good number of these funds were established before 1980, in the context of the build-up of oil revenues during the 1970s. Two of the largest SWFs were founded over 25 years ago – the Abu Dhabi Investment Authority in 1976 and Singapore's Government Investment Corporation in 1981. Thanks largely to huge increases in oil revenue, the number of SWFs doubled from 20 to 40 between the years 2000 and 2005. Nowadays, they are powerful, globally active economic agents, most of them concentrated in Asia and in the Arab region. The Abu Dhabi Investment Authority, established in 1976, is currently the largest



---

SWF, followed by Norway, Singapore, Kuwait and China (see UNCTAD, 2008: 20–26).

Estimates are that SWFs manage assets of approximately \$5 trillion, which amounts to more than half of official global foreign exchange reserves. It is expected that this amount will grow to \$10 trillion by 2012.<sup>17</sup> However, compared to pension funds (which have \$22.5 trillion in assets) or insurance companies (which have \$16.5 trillion in assets), the assets managed by SWFs are still relatively modest. Furthermore, FDI by SWFs was only \$10 billion in 2007, accounting for a mere 0.2 per cent of their total assets and only 0.6 per cent of total FDI flows (*ibid.*, p. 21).

A sovereign wealth fund can be defined as a fund which is owned by the State or the Government and which is composed of financial assets such as stocks, bonds, property, gold, currencies and other investment vehicles. In essence, these are the financial assets of countries for the purposes of investment. However, no uniform type of SWF exists; SWFs may differ substantially between themselves concerning their financial assets, their connection to government, their investment strategies and operational targets. The majority of these funds consist of accumulated foreign exchange reserves generated from budgetary and current account surpluses (Hoegge, 2007). Most SWFs derive the major portion of their funding from revenues from natural resources, but some of their revenues are also derived from privatizations.

SWFs serve governments as an investment vehicle that is used to acquire greater returns on their cash reserves by investing in equities and other assets abroad. Governments manage these assets separately from the official reserves of the monetary authorities (the central bank and reserve-related functions of the finance ministry).

SWFs may have a positive impact on the host country economy, since they provide much-needed capital and can afford to be patient until profits are realized. In connection with the current financial crisis resulting from the United States subprime mortgage market, for example, SWFs from Singapore and Abu Dhabi injected capital into affected Western banks. This kind of investment into Western financial institutions (and other affected industries) is likely to increase further in 2008 and 2009.

On the other hand, concerns have been expressed that SWFs may act differently from private companies in certain future scenarios, and that they could use their economic power for political purposes. This reflects the belief that the business behaviour of foreign State entities would not exclusively be based on economic criteria, since they are closely connected to the political power centres in their home countries. It has been argued that SWFs are inherently different from private investors, since government-owned entities may have interests that take precedence over profit maximization (*ibid.*, pp. 24–26).<sup>18</sup>

Another major concern emanates from the fact that SWFs have strategic industries on their shopping list. Sectors targeted include energy, financial services, foreign technologies, research and development (R&D), as well as famous brand names from developed economies (Casarini, 2007).<sup>19</sup>

A perceived lack of transparency and accountability of the SWFs has also provoked unease.<sup>20</sup> Lack of transparency fuels speculation. Very few SWFs publish detailed information about their assets, liabilities or investment strategies.

Several suggestions have been made to address concerns in connection with SWFs. Among them are to invest at arm's length, to be more transparent, and to use independent asset managers. Another proposal has been that SWFs should develop a code of conduct jointly with the governments of developed countries.

Reference has also been made to the Norwegian State Fund, as one of the rare examples where the investment activities of such bodies are subject to an ethical code. In October 2007, the Group of Seven (G-7) called for rules to guide the international investments of government-run funds, in order to provide better oversight of their operations. These initiatives aim at identifying best practices for SWFs in such areas as institutional structure, risk management, transparency and accountability. The group asked the International Monetary Fund (IMF), the World Bank and the OECD to examine the issue. In April 2008, the OECD adopted guidelines for recipient-country investment policies relating to national security (see box 2). The European Commission is likewise active in this field. In September 2008, an IMF working group mandated to develop a code of conduct for SWFs agreed upon a draft, called the “Santiago Principles”. This code is expected to go some way towards increasing transparency, particularly in respect of SWFs’ operating structures and investment strategies. At the time of writing this paper, the content of these principles had not yet been published.

A code of conduct could cover a variety of issues, including rules on separating responsibilities within fund structures so that investment decisions are made independently of politicians. It could also call for the publication of an investment policy defining overall objectives, operational autonomy for the fund to achieve its targets, and disclosure of general principles governing the relationship with the sponsoring government. Provisions related to transparency might include annual disclosure of investment positions and asset allocation, and publication of information on the use of loans and currencies. It could also include rules on publicizing the size and source of the fund’s resources and how it exercises voting rights of stocks that it holds.

**Box 2. OECD guidelines on investment policies relating to national security**

OECD countries have reiterated that they welcome investments from sovereign wealth funds as a positive force for development and global financial stability. In this context, they have endorsed guidelines developed under the auspices of the OECD Investment Committee to ensure that investment measures to safeguard national security are not, in fact, disguised protectionism. The OECD Investment Committee has produced a report on OECD guidelines for recipient-country investment policies relating to national security. The report was approved by Governments on 4 April 2008.

The guidelines are grounded in the investment policy principles of non-discrimination, transparency and liberalization. More specifically, the guidelines reiterate that governments should rely on measures of general application, which treat similarly situated investors in a similar fashion. If such treatment is not compatible with the protection of national security, specific measures can be taken with respect to individual investments.

The guidelines also emphasize the importance of transparency in regulatory practices. For example, laws should be codified and made available to the public, governments should seek the views of interested parties when considering changes to investment policies, and strict time limits should be applied to review procedures for foreign investment.

It is also clarified that restrictions on investment should not be exaggerated or be greater than what is strictly needed for the protection of national security. The guidelines specify that national security concerns are self-judging, and that it is up to governments to decide what is necessary to protect national security. However, such restrictive investment measures should be focused and tailored to the specific risks posed by a particular investment operation. They should only be used as a last resort when other policies cannot be used to eliminate the national security concerns.

/...

**Box 2. OECD guidelines on investment policies relating to national security (concluded)**

In order to guarantee the rights of foreign investors, the guidelines emphasize the accountability of the authorities implementing the restrictive measures. Foreign investors can seek a review of decisions to restrict foreign investments through administrative procedures or before judicial courts. These efforts aim at ensuring accountability, predictability and fairness in the implementation of restrictive investment policies.

*Source:* UNCTAD, based on the OECD Guidelines for Recipient-country Investment Policies relating to National Security. Available at: <http://www.oecd.org>

A suggestion has also been made that the special features of SWFs would provide sufficient justification for treating them differently from foreign investment that is usually privately owned. Thus, one could imagine establishing a special regime for SWFs whereby the definition of “investment” in IIAs would exclude them, while still allowing them to be covered in certain specified circumstances. For instance, disputes relating thereto would be treated as State–State disputes, not as investor–State disputes.

Up until now, the above fears about SWFs have not materialized. No cases are known where foreign state funds have actually turned into political agents and have in any way posed a threat to national security. Importantly, SWFs have, up to now, only acted as financial investors and have not sought to acquire control over the companies in which they hold shares.

Moreover, it should not be forgotten that SWFs – as any other foreign investor – are subject to the legislation of the host country where their investment is made. These funds cannot therefore simply behave as they wish. If host countries believe that

these funds are acting in a non-desirable manner, then the host countries can always take corrective actions. However, in this case, the host country risks a confrontation with the respective foreign State, and therefore a political incident. This is different from regulating the behaviour of private investors, where the risk of a political conflict with the home country is smaller. This might have important implications in the case of an investment dispute involving SWFs. In the case of a private investor, such disputes are usually resolved in the framework of investor–State dispute settlement procedures. However, when SWFs are involved, one could argue that the inter-State dispute settlement rules shall apply.

*(c) Threshold for invoking national security interests*

There is the issue of what degree of involvement foreign investors must have in a domestic company before they can be considered to be a risk for the strategic policies of the host country and/or for national security. Is it necessary for the foreign investor to become the owner of the domestic firm, and if not, at what point can one assume that the foreign investor actually controls the domestic firm? No international consensus exists on this matter, as individual countries have set different benchmarks. These range from a mere 25 per cent ownership share, to acquiring a majority share.

In this context, the OECD project on Freedom of Investment, National Security and ‘Strategic Industries’ – which was initiated in 2006 – aims at establishing common policy guidelines for national security considerations in connection with foreign investment. The three policy areas that emerged are (i) transparency/predictability, (ii) regulatory proportionality, and (iii) accountability. More specifically, regulatory objectives and practices should be made as transparent as possible so as to increase the predictability of outcomes, while at the same time

---

protecting the confidentiality of sensitive information. With regard to regulatory proportionality, restrictions on investment should not be greater than needed to protect national security, and they should generally be avoided when other existing measures are adequate and appropriate to address a national security concern. As far as accountability is concerned, the OECD project calls for procedures for parliamentary oversight, judicial review, periodic impact assessments, and requirements that decisions to block an investment should be taken at high government levels.<sup>21</sup>

## **B. The role of IIAs**

### **1. The need to balance conflicting interests**

Host countries and foreign investors have potentially conflicting interests when it comes to national security considerations in respect of foreign investment. Host countries have the right to regulate, and tend to seek a maximum of freedom to react to a perceived threat to their national security. Foreign investors, by contrast, want the highest possible level of protection and predictability when making an investment in a host country. IIAs therefore need to fulfil a dual purpose: on the one hand, they need to give appropriate protection to foreign investors so that they feel attracted to the host country, and on the other hand, they must give sufficient comfort to the Contracting Parties that they remain able to regulate foreign investment for national security reasons. How, then, do IIAs set the balance between promoting and protecting foreign investors, and safeguarding national security interests?

National security concerns can be assumed to generally override the interests of foreign investors as regards receiving investment protection in IIAs. However, recent developments to expand the concept of national security beyond military threats and to also cover economic concerns raise new questions about the

“right” balance between investment protection and the safeguarding of State interests. Originally developed during the Cold War as an instrument to deter investments from actual or potential enemies and to prevent them from gaining access to military-relevant technology, the concept has gained a much broader scope. While it is one thing to acknowledge a country’s sovereignty in matters of war and peace, the predominance of the State interest becomes more problematic in relation to the defence of strategic industries, where the borderline with economic protectionism may often be blurred. As far as economic crisis is concerned, it is likewise unclear what the degree of severity of a crisis must be in order for this to be a valid reason for imposing investment restrictions.

This has several consequences. Firstly, countries that did not include a security exception in their IIA at all, because they thought that its scope would be limited to military threats and comparable events and that they would be able to deal with such situations without violating the agreement, might now wish they had a security exception in order to be better able to adopt measures aimed at protecting their strategic industries or to react to economic crises. Conversely, countries that only reluctantly accepted a national security exception because they could see a need for it only in the remote case of a military threat or a similar emergency might now be confronted with situations where the other Contracting Party gives it a much broader meaning and also seeks to protect its strategic industries under it or invoke it in the case of economic crisis.

In addition, the potential coverage of strategic companies and economic crisis under the national security exception raises new questions concerning the conditions under which the clause may be invoked. The broader the scope of the provision, the more foreign investors and their home countries could argue that this enlargement needs to be counterbalanced by some safeguards limiting the otherwise endless discretion of Contracting Parties.



---

This would be all the more important if the security exception had the effect of liberating the Contracting Party concerned from any obligation that it had assumed under the IIA.

## **2. The distinction between the pre- and the post-establishment phases of an investment**

Host countries have to worry that an IIA limits their freedom to restrict foreign investment for national security reasons only insofar as the agreement imposes obligations on the Contracting Parties. Here, a crucial distinction needs to be made between IIAs that exclusively cover the post-establishment phase, and those that extend to the pre-establishment phase.

Whether an IIA applies to a situation where a host country imposes restrictions on foreign investors for national security reasons depends on two variables: firstly, whether the restriction relates to the establishment of foreign investors or to their treatment after establishment, and secondly, whether the relevant IIA covers post-establishment treatment only or also extends to the pre-establishment phase.

The only situations where an IIA would be irrelevant are those in which an investment restriction based on national security considerations relates to the entry of foreign investors and where the applicable IIA is limited to the post-establishment phase of an investment. This is the typical scenario when it comes to national security concerns in relation to planned foreign takeovers of strategic industries. Thus, countries concluding IIAs limited in scope to post-establishment retain full flexibility in imposing security-related restrictions on foreign investors in strategic sectors, as long as they do not adopt measures in respect of established investors. The situation is different, however, when it comes to responses to economic crisis. Here, the typical case is that the host country takes measures against established investors.

Consequently, such measures fall within the scope of IIAs covering the post-establishment phase.

*(a) National security interests and the entry of foreign investors*

National security considerations primarily become relevant in connection with the establishment of foreign investors, be it in the form of greenfield investment or as mergers and acquisitions. On the other hand, the majority of IIAs do not cover the pre-establishment phase, i.e. they do not impose any binding obligations on Contracting Parties concerning the admission of foreign investment. Accordingly, these IIAs do not prevent Contracting Parties from denying foreign investors access for national security reasons.

Notwithstanding this general approach, most of the IIAs falling into this category do not remain completely silent with regard to the entry of foreign investors. They usually contain a political commitment to create favourable conditions for foreign investment from the other Contracting Party and may further stipulate that such investment shall be admitted in accordance with the host country's legislation. Thus, a policy of rejecting foreign investment for national security reasons might be questioned as being at odds with the general objective of the agreement to create a welcoming environment for foreign investors. Whether such allegations would be justified very much depends on the circumstances of the individual case, in particular whether there are signs of a systematic rebuff of foreign investors and whether the host country interprets the notion of "national security" in a very broad or narrow manner. However, under no circumstances could even the most restrictive policy of a host country amount to a treaty violation.

The situation may be different in the case of the minority of IIAs that cover the pre-establishment phase, i.e. those that include

binding obligations concerning the entry of foreign investors. Treaties falling into this category usually subject Contracting Parties to the principle of non-discrimination; that is to say, they grant foreign investors national treatment and most-favoured-nation treatment with regard to their establishment in the host country. In this case, at least theoretically, the rejection of a foreign investor for national security reasons could amount to a violation of the non-discrimination standard.

However, the national security exception would, in all likelihood, not be the host country's only potential safeguard in the case of entry restrictions. Recourse to this defence might not be necessary if the non-discrimination principle does not apply, because the host country has carved out the specific sector or activity from its scope of application. With regard to security-sensitive sectors or activities, it is unlikely that a country would grant a right of establishment to foreign investors. In the absence of such a right, there would therefore be no need to invoke a national security exception to block the entry of foreign investors.

The situation may, however, be different with regard to sectors or activities that – while not directly being sensitive for national security reasons – nevertheless are of strategic importance for the host country. Which sectors or activities are strategically important is more open to subjective judgement than the relatively narrowly defined term “national security”. Also, it is likely that the categorization of activities or sectors as strategically important will change over time, for instance in connection with the coming to power of a new government and subsequent changes to economic policies. Thus, an activity or sector not considered as being of strategic importance at the time that an IIA is concluded may be regarded as strategically significant at a later stage. Consequently, if Contracting Parties have granted a right of establishment with regard to this activity or sector in the IIA, they would be violating their treaty obligations if they later denied foreign investors access,

unless the treaty included a national security exception broad enough to cover the activity or sector at stake.

Most IIAs have only a limited importance when it comes to entry restrictions for foreign investors based on national security considerations, since they do not cover the pre-establishment phase of an investment. Even the minority of IIAs that grant establishment rights might be only partially relevant, because they are likely to expressly exclude sectors or activities relevant to national security from the pre-establishment obligations of the Contracting Parties. What basically remains, then, are entry restrictions in respect of strategically important industries not covered by sector-specific reservations. While the relevance of IIAs in respect of national-security-related entry restrictions for foreign investors is currently relatively modest, the situation may change as more and more free trade agreements dealing with establishment rights for foreign investors are concluded.

***(b) National security interests and post-establishment treatment of foreign investors***

While national security concerns related to strategic industries primarily become relevant in connection with the establishment of foreign investors, measures taken in times of economic crisis predominantly affect already established investments. In addition, the latter may also be the addressee of investment restriction in favour of domestic strategic industries, such as the energy sector, telecommunications, or the water supply. For instance, there have been several cases recently where governments have demanded that established foreign investors renegotiate existing investment contracts or give up their investment altogether.

- **Imposition of other emergency measures**

National security considerations may affect any kind of established foreign investment, irrespective of the specific sector or

activity in which it is involved. This became apparent, for instance, in the context of the Argentinian financial crisis in 2001, when the Argentinian Government adopted a number of emergency measures to stabilize the economy. These measures were not specifically targeted at companies engaged in security-related industries, rather they affected investors across the board. When confronted with allegations that such measures violated Argentina's obligations under existing IIAs, the country argued that these actions were justified for national emergency reasons.<sup>22</sup> As a result of the emergency measures taken by Argentina, the country has been involved in more than 44 investor-State disputes directly related to the crisis.

Emergency measures taken in times of financial crisis may include capital transfer restrictions and may, therefore, contravene IIA provisions on the freedom of capital transfers. They may also be in conflict with other IIA provisions, such as those on expropriation, the principle of non-discrimination, the standard of fair and equitable treatment, and the obligation to grant full protection and security.<sup>23</sup> If a host country violates these IIA standards, then, once again, the question arises whether such a violation can be excused by referring to a national security exception in the agreement.

- **Forced disinvestment**

It may happen that after the investment has been made, the host country finds out that the investment is involved in activities that are security-sensitive. Another possible scenario is that the investment has been made in an activity or sector that was not considered to be security-relevant at the time when the investment was made, but was later qualified as such by the host country. Likewise, it may turn out that that after establishment, the host country declares the relevant economic sector as being of strategic importance and wishes to reserve it for domestic enterprises.

If a host country concludes that an established foreign investment poses a threat to national security, it may wish to deprive the foreign investor of the investment, either by closing it down or by forcing him to sell it to a domestic enterprise. It may also demand the renegotiation of an existing investment contract. This leads to the question of whether the host country would be required in these situations to compensate the foreign investor under the expropriation rules or the umbrella clause of an IIA. This depends, among other things, on whether the relevant IIA contains a national security exception that exempts the host country from the obligation to pay compensation in such a situation (see section II.D).

### **3. National security interests and the “denial of benefits” clause**

Several IIAs contain a so-called “denial of benefits” clause, which gives Contracting Parties the right to deny investments the advantages of the treaty under certain conditions. One such condition deals with the issue of diplomatic relations. Accordingly, the denying Contracting Party has the right to deny the benefits of the IIA to an investment if it is controlled by investors of a third country with which the denying party does not maintain diplomatic relations. Therefore, if the host country has security-related concerns with regard to a specific foreign investment, these concerns may justify the denial of benefits if the concerns are reflected in the absence of diplomatic relations with the third country. In addition, some IIAs also allow the host country to invoke the denial-of-benefits clause if it generally prohibits transactions with this third State, for instance in the case of an economic or political embargo.

For example, the Energy Charter Treaty (1994)<sup>24</sup> includes a denial-of-benefits clause which reads as follows:

*Article 17**Non-application of Part III in certain circumstances*

*Each Contracting Party reserves the right to deny the advantages of this Part to:*

...

*(2) an Investment, if the denying Contracting Party establishes that such Investment is an Investment of an Investor of a third State with or as to which the denying Contracting Party:*

*(a) **does not maintain a diplomatic relationship;***

*or*

*(b) adopts or maintains measures that:*

*(i) **prohibit transactions with Investors of that State;** or*

*(ii) would be violated or circumvented if the benefits of this Part were accorded to Investors of that State or to their Investments. (Emphasis added.)*

Similar language can be found in the BIT between the United States and Uruguay (2005) or in the BIT between Canada and Peru (2006), although the latter does not include the absence of diplomatic relations as one of the justifications for invoking the denial-of-benefits clause.

It follows from the above that a denial-of-benefits clause has a narrower scope of application than a national security exception. Not only is the absence of diplomatic relations or an economic embargo a rare situation, but the denial-of-benefits clause also requires that these scenarios exist in conjunction with a third country being the home country of the controlling investor. By contrast, a national security exception could apply in all cases where the host country is concerned about the impact of a foreign investment on its national security – irrespective of the state of diplomatic relations or the existence of an embargo.

#### 4. IIAs and customary international law

If national security concerns are reflected in IIAs in the form of an exception clause, the treaty becomes the main yardstick against which to assess whether a host country's measures aimed at restricting foreign investment for national security reasons have been legal or not. However, even in the absence of any national security exception in the IIA, the host country may nevertheless be able to justify its measure under the rules of customary international law. These rules remain applicable in case an IIA remains silent on the issue of national security. At the same time, it becomes important to know to what extent customary international law exempts them from international liability in case they restrict foreign investment for national security reasons. Or, in other words: would an excuse under customary international law have the same legal effects as an express exception provision?

Customary international law provides States with some legal flexibility in exceptional circumstances. Among these situations are force majeure, distress, and necessity, each of which can relieve a State from international responsibility. Force majeure can be invoked where "acts of God" outside a State's control occur and make it impossible for the State to fulfil its legal obligations. Distress happens when a State has no other way to safeguard a life in its care than to violate a legal rule. Necessity arises when a State has no other means available to safeguard an essential interest and can do so without harming an essential interest of another State (Burke-White and von Staden, 2007). It is the latter defence that is of particular relevance in the present context.

It is important to note that the customary defence of necessity only applies within narrow limits. According to the International Law Commission (ILC), the action taken must be "the only way for the State to safeguard an essential interest against a grave and imminent peril", and it is essential that that action "does not seriously impair an essential interest" of another State.<sup>25</sup>



Threats to national security are covered under article 25 of the Draft Articles on Responsibility of States for Internationally Wrongful Acts, adopted by the ILC at its fifty-third session (2001),<sup>26</sup> which provides that:

*Article 25*

*Necessity*

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

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

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

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

*(a) The international obligation in question excludes the possibility of invoking necessity; or*

*(b) The State has contributed to the situation of necessity.<sup>27</sup>*

The International Court of Justice (ICJ) confirmed this restrictive reading of necessity in the *Gabcikovo-Nagymaros Project* case, stating that the defence was inapplicable because other means were available to Hungary to remedy the situation.<sup>28</sup> An act is thus only necessary for the purpose of the necessity defence if it is the *only* means of securing an essential State interest. A variant of this approach has been applied by the jurisprudence of the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO). For instance, deciding upon the issue of whether an import ban for cigarettes would be necessary to protect

human health, a GATT panel ruled that the pertinent action could only be justified if it was the *least restrictive means* of achieving the legitimate policy objective.<sup>29</sup>

Hence, customary international law provides justification for States to derogate from IIA obligations, even when it is not expressly mentioned in the treaty. Therefore, IIA parties cannot be held responsible for breaching the treaty when taking measures for the protection of their national or essential interests is permitted under customary international law. States may therefore have a double layer of justification for invoking the national security exception: international customary law and international treaty law. A major distinction between the two approaches is that customary international law removes State responsibility after the actual violation of a certain legal obligation, while national security exceptions in IIAs prevent a treaty violation in the first place. As a result of including national security clauses in their IIAs, States have created “a treaty-based legal mechanism to allocate risks between themselves and investors in extraordinary circumstances, that is distinct from, but coexistent with, defences otherwise available in customary international law” (Burke-White and von Staden, 2007).

Compared to national security exceptions in IIAs, the customary international law defence of necessity therefore removes, in general, a narrower array of State actions from international liability. Customary international law thus cannot be an equivalent substitute for an explicit treaty exception. For example, it is doubtful whether customary international law could provide an excuse for protecting strategic industries. One could argue that the customary law on necessity covers economic crises resulting in social upheavals or affecting the human rights of the population. Accordingly, the protection of strategic industries could only be justified under customary international law if it occurred in the context of such a crisis. Furthermore, it is uncertain to what extent customary international law could justify entry restrictions for

---

foreign investors, even in economic sectors that are directly linked to national security. As has already been mentioned, such restrictions could only be defended if there were no other means available – such as control measures after establishment – to achieve the intended policy objective.

### **C. Main policy issues concerning the protection of national security interests**

Once IIA negotiators have agreed upon the idea of a national security exception, a number of crucial questions arise as to what it should look like. As will be explained in more detail in the following chapter, numerous drafting options exist on how to define “national security” and how to establish the conditions under which the national security exception may be invoked. At one extreme is an approach that leaves total freedom to the Contracting Parties to decide whether there is a threat to national security and how to respond to it. At the other end of the spectrum is a policy that subjects the invocation of the national security exception to a number of conditions, and allows for a thorough judicial review of the measure taken.

A related issue concerns the possible effects of a national security exception in IIAs. Would this exempt the respective Contracting Parties from all of its IIA-related obligations, or are there some core commitments that need to be respected under all circumstances?

Another preliminary question has to do with investments by SWFs. Given that in these cases the investor is a State, one may ask whether IIAs cover such investment activity.

### **1. The degree of autonomy of Contracting Parties in invoking a security-related exception**

A key question concerning the application of national security exceptions in IIAs is to what extent arbitration tribunals have to respect the initial determination of the host country authorities as to whether the individual investment poses a threat to national security or not. The greater the margin of appreciation reserved to the host country, the higher the degree of regulatory flexibility of Contracting Parties is, and the more limited the protection is that IIAs may afford to foreign investors in such cases.

An important challenge facing countries when invoking national security exceptions is to be careful that the measure is not interpreted or perceived by foreign investors as a protectionist measure, or as an excuse to derogate from IIAs obligations. A sensitive question is how to judge whether or not a measure taken by a host State was in reaction to a “real” threat or not. Moreover, how can it be established whether the measures taken by the Government were appropriate and not disproportionate or abusive? Finally, there is the need to ensure that these measures, in the case of a national security crisis, are taken in a non-discriminatory manner.

An important question in this context is whether the nature of the perceived threat to national security should make any difference for the degree of discretion of Contracting Parties under the IIA. One could argue that a higher level of autonomy is justified when it comes to reaction to military threats and other emergency situations, while the discretion of the host country should be more limited in connection with investment restrictions that primarily have a different background.

Two main approaches in IIA practice can be distinguished, in the sense that the national security exception may be self-judging or not.

*(a) Self-judging clauses*

Many IIAs leave it to the discretion of the Contracting Parties to determine when there is a threat to their national security and how to react to it. The typical formulation is that the treaty shall not preclude a Contracting Party from taking such measures that it considers necessary for the protection of its national security. Where IIAs contain such a clause, arbitration tribunals are, in principle, barred from a judicial review of the measure at stake.

The ample discretion of host countries manifests itself not only with regard to the identification of those industries that it considers as sensitive to its national security, or with regard to determining whether there is an economic crisis. The self-judging character of the concept also becomes obvious with regard to the concrete measure that the host country considers to be necessary in response to the perceived threat to national security. Under a self-judging clause, it is the exclusive prerogative of the host country authorities to assess whether the intended investment poses a threat to national security, and how to react to this threat.

The broadness and opaqueness of the term “national security” allows host countries to restrict foreign investment for many reasons. Restrictions may apply in respect of a potentially huge number of economic sectors or activities, and in respect of foreign investors of numerous nationalities.

On the other hand, it has been argued that the self-judging nature of a national security exception in IIAs does not provide a complete shield from judicial scrutiny. States remain subject to the general obligation of the Vienna Convention on the Law of

Treaties (article 26) to carry out their commitments in good faith. Therefore, where a State's invocation of the clause is not made in good faith, the country becomes liable under the treaty. However, it appears that it would be difficult to establish a treaty violation on this basis. One example could be contradictory behaviour by a State, for instance in a situation where a State invokes a national security threat as a defence in investment dispute procedures, whereas it can be shown that in its internal assessment it denies such a threat.

Although good faith has been a core principle of international law for a long time, the precise meaning of this concept is not very clear.<sup>30</sup> In connection with the evaluation of the good faith test under the United Nations Convention on the Law of the Sea (article 300), the International Whaling Commission concluded that good faith requires "fairness, reasonableness, integrity and honesty in international behaviour".<sup>31</sup> The paucity of existing case law means that arbitration tribunals have to develop their own interpretations of this standard. It has been suggested that the good faith principle should include two elements: firstly, whether the State has engaged in honest and fair dealing, and secondly, whether there is a rational basis for the assertion of the national security exception (Burke-White and von Staden, 2007). Thus, for a national security exception to be invoked in good faith, the question a tribunal must ask is whether a reasonable person in the State's position could have concluded that there was a threat to national security sufficient to justify the measures taken.

It follows from the above that a self-judging national security exception in IIAs does not entirely exempt Contracting Parties from international responsibility when they invoke this clause in connection with restrictions imposed on foreign investment. The good faith requirement gives arbitration tribunals a yardstick at hand against which to judge the legality of the measure. This allows tribunals, in particular, to distinguish between justified national security concerns on the one hand, and

measures constituting a disguised form of protectionism on the other. Also, under the good faith test, it might become more difficult for Contracting Parties to justify the protection of strategic industries under a national security clause.

*(b) Non-self-judging clauses*

There are IIAs that do not specify any degree of deference to be accorded to the Contracting Parties when invoking the national security exception. In this case – absent non-textual elements indicating that the parties considered the national security exception self-judging<sup>32</sup> – arbitrators are, in general, entitled to review the legality of the measure and to make their own assessment as to whether such a measure can be justified on national security grounds. This includes an evaluation of whether or not there has been a threat to national security, and whether the State's measure has been a necessary response to this threat.

However, as in the case of a self-judging national security exception, this outcome is subject to some qualifications. The fact that such a clause is not self-judging does not automatically translate into an assumption in favour of a full review to the extent that arbitrators may fully replace a State's assessment of the situation and the measures necessary to remedy it with their own. The permissible objectives of the IIA or specific language employed in defining the nexus requirement between the perceived threat and the response to it may indicate or even necessitate a lower standard of review that gives greater deference to the State's own assessment (Burke-White and von Staden, 2007).

By its very nature, the concept of national security cannot be interpreted in complete isolation from the domestic constituency. The concept would lose its meaning and purpose if a third party had the power to impose on a State that felt threatened its own view about whether such a threat actually exists and what measures, if any, that State is allowed to take in response. It is

much more difficult to subject highly sensitive policy areas such as national security to the same degree of judicial review as more technical legal terms such as the most favoured nation clause or compensation standards. Accordingly, it has been argued that it is doubtful whether any tribunal acting judicially can override the assertion of a State that a dispute affects its security.<sup>33</sup>

Such a view would acknowledge that a situation where a national security exception is invoked may be subject to a spectrum of assessments. It would recognize that countries may have different views concerning the intensity of a threat required to trigger the exception clause, and that there may be a range of possible adequate responses to such a threat. The principal task for the arbitration tribunal would then be to determine the appropriate boundaries of the margin of appreciation, and hence, the respondent State's freedom of action (Burke-White and von Staden, 2007).

These boundaries may be different from case to case. Important determinants are the treaty language and the context in which it was negotiated. It has been suggested that deference would be smallest with regard to situations in which objective standards are available for assessing the permissible objective of the measure and the required nexus, and would be largest where such standards are missing.<sup>34</sup> Accordingly, a judicial review of measures aimed at protecting strategic industries might be less problematic than in cases where a military threat is at stake.

Given these uncertainties in the interpretation of non-self-judging national security exceptions, it is no surprise that recent jurisprudence has not always been consistent. This is illustrated by a number of arbitral awards concerning the legality of emergency measures taken by Argentina in response to its economic crisis at the beginning of this century.<sup>35</sup> In these awards, the tribunals had to decide whether these emergency actions were covered by the national security exception included in the BIT between Argentina and the United States (1991). Whereas in the cases *CMS v*



---

*Argentina*,<sup>36</sup> *Enron v Argentina*<sup>37</sup> and *Sempra v Argentina*<sup>38</sup> the tribunals ruled that the exception was inapplicable, the tribunals in *LG&E v Argentina*<sup>39</sup> and *Continental Casualty*<sup>40</sup> came to opposite conclusion.

## **2. The effects of a security-related exception**

The significance of a national security exception for host countries and foreign investors also depends on how far-reaching its legal effects are. As will be further explained in chapter IV, different options exist in IIAs in this respect. The Contracting Party invoking the exception may be completely exempted from any IIA-related obligation, or it may remain bound by some core commitments, for instance in respect of an expropriation. Another approach is to limit the applicability of the national security exception to certain IIA provisions, so that it cannot be invoked with regard to the rest of the agreement.

## **3. Sovereign wealth funds as protected investors**

Most IIAs do not specify whether or not State funds are covered as “investors”. The term “investor” generally includes natural persons and legal entities. The latter term is usually broadly understood as any kind of juridical entity constituted or organized under the applicable laws of a party. This means that, unless the IIA states something to the contrary, State enterprises or the State itself are normally protected under the IIA. Some IIAs even clarify in greater detail that public institutions and Government agencies are protected under the treaty. This is the case, for example, of the BITs concluded by Saudi Arabia. A typical formulation of this approach is exemplified in the BIT concluded between Saudi Arabia and Malaysia (2000).

*Article 1*  
*Definitions*

3. The term “investor” means:

(a) in respect of Malaysia:

(i) any natural person possessing the citizenship of Malaysia in accordance with its laws; or

(ii) any corporation, partnership, trusts, joint-venture, organization, association or enterprise incorporated or duly constituted in accordance with its applicable laws.

(b) in respect of the Kingdom of Saudi Arabia:

(i) natural persons possessing the nationality of the Kingdom of Saudi Arabia in accordance with the law of the Kingdom of Saudi Arabia;

(ii) any legal entity constituted in accordance with the laws of the Kingdom of Saudi Arabia and having its head office in its territory such as corporations, enterprises, cooperatives, companies, partnerships, offices, establishments, funds, organizations, business associations and other similar entities irrespective of whether or not they are of limited liability; or

(iii) **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.)

#### D. International jurisprudence and national security

As will be seen below, national security exceptions are often formulated in a very broad manner and can thus be somewhat nebulous. Hence, the question arises whether international jurisprudence (e.g. ICSID or NAFTA awards, GATT or WTO tribunals, judgments of the ECJ or the ICJ) can be referred to in

order to clarify the meaning and content of such exceptions, to achieve more consistency and predictability in their application, or to give some guidance to IIA negotiating partners who wish to draft the exception clause in greater detail.

The body of case law available for such an analysis is relatively small. Even though security reasons are often used as grounds for States to justify derogation from treaty obligations, this justification has seldom been subject to judicial scrutiny in the context of IIAs, except for the exemptions provided for in the Treaty on European Union. It seems, therefore, that it cannot yet provide a robust basis in this regard. On the contrary, deviating in their approaches and findings on almost identical factual backgrounds, different ICSID tribunals have come to very different conclusions. Therefore, considerable uncertainty remains as to the applicability and substantial requirements of national security exceptions when it comes to arbitration.

### **1. International Centre for Settlement of Investment Disputes (ICSID)**

Only very limited case law exists concerning arbitral awards under the ICSID convention dealing with national security clauses in BITs. As has already been mentioned, five awards have been rendered in recent years, all of them dealing with claims filed by United States companies against Argentina in response to measures taken by the Argentinian Government as a reaction to the severe economic crisis in 2001–2002.<sup>41</sup> The claimants argued that these measures had harmed their investments in the Argentinian gas and insurance sectors and had violated the BIT between the United States and Argentina. A considerable number of further awards are expected to be rendered in the near future dealing with similar questions against the background of this crisis.<sup>42</sup>

In all of the concluded cases, the issue at the heart of the dispute was whether the emergency measures taken by Argentina at a time of severe economic crisis (i) fall within the scope of the national security exception contained in the BIT between the United States and Argentina, or (ii) could be justified by the customary international law defence of necessity. Only in two cases did the tribunal hold that the measures taken were justified for a certain period of time under the treaty clause with the consequence that Argentina could not be held responsible for losses suffered by the claimant during that time.<sup>43</sup> In contrast, the other tribunals did not accept Argentina's defence, and held it to be liable to pay compensation. As one of these tribunals formulated, there are concerns that "*any State could invoke necessity to elude its international obligations. This would certainly be contrary to the stability and predictability of the law.*"<sup>44</sup>

The relevant article XI of the Argentinian–United States BIT that was invoked by Argentina in the proceedings mentioned reads as follows:

*This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.*<sup>45</sup>

**(a) Relationship between the treaty exception and the necessity defence under customary international law**

The first question the tribunals addressed relates to the relationship of the treaty clause to the customary law defence of necessity also invoked by Argentina. For this matter, the tribunals referred to article 25 of the Draft Articles on the Responsibility of States for Internationally Wrongful Acts on State Responsibility of

---

the International Law Commission (in the ILC Articles) which are generally accepted as a codification of existing customary international law.<sup>46</sup>

Except for the tribunals in the *LG&E* and *Continental Casualty* proceedings, no tribunal strictly separated the invocation of article XI of the BIT from the necessity defence under customary international law. In fact, these tribunals read the requirements set out in article 25 of the ILC Articles into article XI of the BIT, thus conflating them to a single, inseparable defence. For example, the Tribunal in the *Sempra* case stated that:

*This Tribunal believes, however, that the Treaty provision is inseparable from the customary law standard insofar as the definition of necessity and the conditions for its operation are concerned, given that it is under customary law that such elements have been defined. Similarly, the Treaty does not contain a definition concerning either the maintenance of international peace and security, or the conditions for its operation.*<sup>47</sup>

The annulment committee to the *CMS* case, however, found this approach to be erroneous in two ways. One error related to the different requirements of these provisions, and the other to their relationship and order of application.

Firstly, it noted that the tribunal had “assimilated the conditions necessary for the implementation of article XI of the BIT to those concerning the state of necessity under customary international law.”<sup>48</sup> It criticized the tribunal for merely assuming that article XI of the BIT and article 25 of the ILC Articles were on the same footing, without entering into an analysis on the relationship of the treaty provision and the rule of customary international law. The committee pointed out that the requirements under article XI of the BIT were not the same as

those under customary international law as codified by article 25 of the ILC Articles; in fact, they were substantively different.

Secondly, the committee held that the *CMS* tribunal made another error of law, as it did not consider the excuse based on customary international law only to be subsidiary to the exclusion based on article XI. It observed that article 25 of the ILC Articles was an excuse only relevant once it has been decided that there had otherwise been a breach of substantive obligations. In contrast, if article XI of the BIT applied, the substantive obligations under the treaty were not applicable.

Notwithstanding these errors identified by the committee, it could not annul the award due to its limited jurisdiction under article 52 of the ICSID convention, since there was no manifest excess of powers. “Although applying it cryptically and defectively,”<sup>49</sup> in the end, the *CMS* tribunal had applied article XI of the BIT.

The findings of the annulment committee in the *CMS* case are congruent to the approach taken by the tribunal in the *LG&E* case. This tribunal applied article XI of the BIT without intermingling the requirements of article 25 of the ILC Articles.<sup>50</sup> The *LG&E* tribunal primarily applied article XI of the BIT, and referred to article 25 of the ILC Articles only as an additional and separate argument emphasizing its findings, and not as a “mere textual restatement of the pre-existing customary defence of necessity”.<sup>51</sup> Also, the *Continental Casualty* tribunal emphasized the difference between the article XI BIT exception and the more severe test required for precluding the wrongfulness of an act under customary international law.<sup>52</sup>

It is impossible to anticipate whether future tribunals will follow the reasoning of the annulment committee in the *CMS* case and of the *LG&E* and *Continental Casualty* tribunals. However, as one commentator pointed out, “given the clarity and substance of

---

the committee's ruling ... the report is likely to have persuasive effect on these pending cases."<sup>53</sup>

*(b) Economic crisis covered by the exception clause*

All tribunals concluded that economic crisis can justify the invoking of a national security exception. However, they disagreed concerning the degree of severity of the crisis required to rely on the clause.<sup>54</sup>

*(c) Self-judging exception?*

As explained above, the question of whether or not a national security exception contained in an IIA is self-judging is of crucial importance.<sup>55</sup> In the Argentine cases, all of the tribunals addressed this issue at some length with regard to article XI of the Argentina–United States BIT and rejected its self-judging nature.

The wording of article XI of the BIT as given above allows the parties to take “measures necessary” – not measures that a party considers as such. Applying a textual approach, and comparing article XI of the BIT with differently worded provisions such as GATT article XXI, the *CMS* tribunal observed that when States intended to create for themselves a right to unilaterally determine the legitimacy of extraordinary measures importing non-compliance with obligations assumed in a treaty, they did so expressly.<sup>56</sup> Article XXI(b) of the GATT prescribes that nothing in the GATT agreement shall be construed to prevent any Contracting Party from taking any action *which it considers necessary* for the protection of its national security. In addition, it referred to the ICJ judgments in the *Nicaragua* case<sup>57</sup> and in the *Oil Platforms* case.<sup>58</sup> In both these cases, the ICJ had decided that the national security exceptions contained in treaties between the United States and Nicaragua and Iran respectively were not self-judging, but subject to judicial review. It based its interpretation on the wording

of the provisions which, unlike GATT article XXI, did not provide for the words “which it considers”. Furthermore, the tribunal referred to the ICJ decision in the *Gabcikovo-Nagymaros* case,<sup>59</sup> in which the ICJ ruled – in relation to the necessity defence under customary international law – that “the State concerned is not the sole judge of whether those conditions have been met”.

The *LG&E* tribunal, in contrast, grounded its finding on the interpretation of the treaty by the parties at the time of its signing. According to the tribunal, the United States only began to consider the application of the exception clause to be self-judging with the ratification of the BIT between the Russian Federation and the United States.<sup>60</sup> The *Enron* and *Sempra* tribunals used both reasons to support their conclusion.<sup>61</sup> The *Continental Casualty* tribunal, finally, based its judgment on the wording of the clause, and found no evidence that despite the language used, the Contracting Parties would have considered the exception as being self-judging.<sup>62</sup>

#### ***(d) Compensation***

The fourth issue that is noteworthy in this context is that of compensation. The *CMS* tribunal, by way of obiter dicta, deduced from article 27(b) of the ILC Articles that the plea of state of necessity may preclude the wrongfulness of the measure at stake, but it did not exclude the duty to compensate the owner of the right which had to be sacrificed.<sup>63</sup>

Again, the tribunal in the *LG&E* case took a different stance. It stated that neither article 27 of the ILC Articles nor article XI of the BIT specified whether any compensation was payable to the party suffering from losses during the state of necessity. Nevertheless, and in accordance with its finding that article XI of the BIT exempted Argentina from liability, the tribunal decided that the damages that occurred during the state of necessity had to be borne by the investor.<sup>64</sup>



Similarly, the annulment committee in the *CMS* case held that the *CMS* tribunal should have considered the question of compensation under article XI of the BIT before turning to article 27(b) of the ILC Articles. For the committee, it was clear that since article XI excluded the applicability of the substantive provisions of the BIT, there could be no obligation to pay compensation during that period.<sup>65</sup>

## **2. World Trade Organization/General Agreement on Tariffs and Trade**

Although decisions by the GATT and WTO panel and Appellate Body do not directly relate to IIAs and do not directly deal with the issue of national security, they nevertheless contribute to a better understanding of the concept of necessity and the nature of self-judging clauses. Ultimately, the key problems and legal issues are similar, be it in the context of BITs or FTAs.

Relevant provisions of the WTO agreements in this context include GATT article XXI and General Agreement on Trade in Services (GATS) article XIV *bis*.<sup>66</sup> As regards the latter, a panel, and subsequently the Appellate Body, construed the terms “public morals” and “public order”. They also decided on when a measure taken to protect public order and public morals could be considered necessary. With respect to GATT article XXI, in early cases the question arose as to whether or not this provision was self-judging.

**(a) Interpretation of “public morals” and “public order”**

In *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, the United States of America invoked article XIV of the GATS to justify a group of state and federal laws which Antigua argued to impose a “total prohibition” with regard to the cross-border delivery of gambling services. The panel in this case was the first one to interpret the terms “public morals” and “public order” from article XIV(a) of the GATS. In its interpretation, it firstly recognized the sensitivities associated with the interpretation of these terms and noted that the content of these concepts for Members can vary in time and space, depending upon a range of factors, including prevailing social, cultural, ethical and religious values.<sup>67</sup> Consequently, and in line with previous decisions of the Appellate Body relating to similar societal concepts, the panel held that States should be given some scope to define and apply for themselves the concepts of “public morals” and “public order” in their respective territories, according to their own systems and scales of values.

It went on to construe the individual components of the terms. It concluded that “public morals” and “public order” were two distinct concepts which sought to protect largely similar values and which may overlap. However, measures taken to protect either of them must be “aimed at protecting the interests of the people within a community or a nation as a whole”. This was the meaning of “public”.

Referring to the ordinary meanings of the terms “morals” and “order”, it then defined “public morals” to denote standards of right and wrong conduct maintained by or on behalf of a community or nation. In the view of the panel, “public order” – also taking into account footnote no. 5 to the article – refers to the preservation of the fundamental interests of a society, as reflected in public policy and law.<sup>68</sup> These fundamental interests could relate, inter alia, to standards of law, security and morality.

In light of this interpretation, the panel regarded the measures at issue as falling within these definitions as they were imposed by the United States to pertain to money laundering, organized crime, fraud, underage gambling and pathological gambling. The Appellate Body later upheld this finding of the panel.<sup>69</sup>

*(b) Necessity of the measure*

With respect to the requirement of article XIV(a) of the GATS that measures taken to protect public morals or the public order must be “necessary”, the panel referred to previous decisions of the Appellate Body in *Korea – Various Measures on Beef* and *EC – Asbestos*, in which it had established parameters for the necessity test under similar provisions of the GATT.<sup>70</sup> In light of these decisions, the panel formulated the following criteria relevant for a weighing and balancing test: (a) the importance of interests or values that the challenged measure is intended to protect; (b) the extent to which the challenged measure contributes to the realization of the end pursued by that measure; and (c) the trade impact of the challenged measure.<sup>71</sup> Importantly, the panel stressed that with regard to the trade impact criterion, the Appellate Body had also indicated that whether a reasonably available WTO-consistent alternative measure exists must be taken into consideration, in applying this requirement. The panel found the United States to have failed to show that this requirement was met: “In rejecting Antigua’s invitation to engage in bilateral or multilateral consultations and/or negotiations, the United States failed to pursue in good faith a course of action that could have been used by it to explore the possibility of finding a reasonably available WTO-consistent alternative.”<sup>72</sup>

The Appellate Body reversed this finding of the panel and held the United States measures to be necessary. In this context, it shed some light on the procedural aspects of the necessity test. It underscored that while the burden to show the necessity of a

measure lay with the responding party in the end, it was not its burden to show, in the first instance, that there were *no* reasonably available alternatives to achieve its objectives.<sup>73</sup> However, a responding party had to demonstrate that a measure raised by a complaining party was no reasonable alternative. Unlike the panel, the Appellate Body did not consider consultations as offered by Antigua as a reasonable alternative, because consultations were by definition a process, the results of which were uncertain and therefore not capable of comparison with the measures at issue in this case. Hence, since Antigua failed to present a WTO-consistent measure, the United States legislation was necessary. However, the Appellate Body upheld the panel's finding (in part) that the measures were in compliance with the requirements set out in article XIV of the GATS, since the United States had not shown that the prohibitions embodied in these measures were applied to both foreign and domestic service suppliers of remote betting services for horse racing.<sup>74</sup>

*(c) Self-judging nature*

The question of whether a security exception such as article XXI of the GATT is not – despite the wording “... which it considers necessary ...” – to be considered as *entirely* self-judging was addressed in an early dispute between Czechoslovakia and the United States of America, concerning an import ban imposed by the latter on national security grounds. During the discussion of the delegates of the Contracting Parties – who were then responsible for dispute settlement – the opinion was put forward that the ban “would seem to be justified, because every country must have the last resort on questions relating to its own security.”<sup>75</sup> At the same time, the parties should be cautious not to take any step that might have the effect of undermining the General Agreement. The Contracting Parties rejected the Czechoslovakian claim. In light of the discussion between the delegates in which recourse was made to article XXI of the GATT, one could argue that the Contracting Parties considered their

---

formal jurisdiction with regard to a defence made under article XXI.<sup>76</sup>

The United States also invoked article XXI of the GATT in relation to a claim by Nicaragua that an executive order issued by President Reagan prohibiting all trade with Nicaragua violated the United States' obligations under the GATT. The terms of reference, on which both parties then had to agree in order for a panel to be established, explicitly barred the panel in this case from examining the validity of this defence. Nevertheless, it took the opportunity to raise "more general questions":

*If it were accepted that the interpretation of article XXI was reserved entirely to the Contracting Parties invoking it, how could the Contracting Parties ensure that this general exception to all obligations under the General Agreement is not invoked excessively or for purposes other than those set out in this provision? If the Contracting Parties give a panel the task of examining a case involving an article XXI invocation without authorizing it to examine the justification of that invocation, do they limit the adversely affected Contracting Party's right to have its complaint investigated in accordance with article XXIII:2?<sup>77</sup>*

Thus, there is good reason to believe that measures taken under article XXI of the GATT are reviewable by tribunals. Arguments for reviewability may even be stronger today, as the process has become more subject to judicial review under the WTO Dispute Settlement Understanding. Hence, disputes are to be resolved using "customary rules of interpretation of public international law" that include good faith (article 3.2 WTO DSU).<sup>78</sup>

### 3. European Court of Justice

The European Court of Justice (ECJ) dealt with the security exception clauses provided for in the Treaty on European Union primarily in the context of the privatization of public undertakings in the infrastructure sector.<sup>79</sup> In infringement proceedings initiated by the European Commission, the ECJ has so far accepted a member State's defence only once.

In the late 1990s, a number of member States established legislation aiming at controlling foreign investment into such undertakings, inter alia by means of prior authorization procedures and rights of veto assigned to the State through a "golden share" in the respective undertaking.

For example, measures adopted by Portugal limited the possibility for nationals of other member States to acquire more than a given number of shares in certain undertakings in the banking, insurance, energy and transport sectors. In addition, prior authorization was required in case a fixed threshold of shares or voting rights held was exceeded. France established a similar procedure with regard to a company supplying it with petroleum products. Moreover, it established a right for the Government to oppose any decisions concerning the transfer or use as security of assets (*ex post facto*). Belgium also installed such a procedure, which was limited to decisions concerning the strategic assets of the companies capable of being used as major infrastructure for the domestic conveyance of energy products. According to Belgian law, the minister responsible could oppose if he or she considered that the operation in question adversely affected the national interest in the energy sector.

In its judgments, the ECJ found these measures to constitute a restriction of the free movement of capital and as a consequence also of the freedom of establishment. With regard to a

possible justification for such a restriction and in line with previous rulings, it held that the free movement of capital may be restricted only under certain strict conditions. First, the restriction must be justified by reasons referred to in the Treaty<sup>80</sup> or by overriding requirements of the general interest and which are applicable to all persons and undertakings pursuing an activity in the territory of the host member State. Second, the national legislation must be suitable for securing the objective which it pursues, and third, it must not go beyond what is necessary in order to attain it, so as to accord with the principle of proportionality.<sup>81</sup> The same standard was applicable to a restriction of the freedom of establishment under article 46 of the Treaty.

With regard to the prior administrative authorization mentioned, it recalled that such a scheme must be proportionate to the aim pursued, inasmuch as the same objective could not be attained by less restrictive measures, in particular a system of declarations *ex post facto*. Also, it had to be based on objective, non-discriminatory criteria which were known in advance of the undertakings concerned, and all persons affected by a restrictive measure of that type had to have a legal remedy available to them.<sup>82</sup>

Against this background, the court found the Portuguese measures to be in violation of these requirements. The economic objectives pursued by the measures in question, namely choosing a strategic partner, strengthening the competitive structure of the market concerned, or modernizing and increasing the efficiency of means of production, could not justify restrictions on the fundamental freedom concerned: “It is settled case law that economic grounds can never serve as justification for obstacles prohibited by the Treaty.”<sup>83</sup>

In contrast, France grounded its measures at issue on the safeguarding of supplies of petroleum products in the event of a crisis. Here, the court held that this objective fell undeniably within the ambit of a legitimate public interest, since ensuring a minimum

supply of petroleum products at all times could justify a restriction as a public-security consideration under the Treaty.<sup>84</sup> Also, in *Commission v Spain*, the court explicitly stated that safeguarding supplies of telecommunications, electricity and petroleum or the provision of such services within a member State in the event of a crisis might constitute a public security reason.<sup>85</sup> However, the court interprets this derogation strictly, so that the scope of this exception cannot be determined unilaterally without any control by the Community's institutions: "Thus, public security may be relied on only **if there is a genuine and sufficiently serious threat to a fundamental interest of society.**"<sup>86</sup> (Emphasis added.)

In this context, the court found that the French system was contrary to the principle of legal certainty, as the investors concerned were given no indication whatever as to the specific, objective circumstances in which prior authorization would be granted or refused. Such a wide discretionary power constituted a serious interference with the free movement of capital. Since the discretion to exercise the right to oppose ex post facto was likewise not limited by any condition, the same consideration applied. Consequently, the court stated that "since the structure of the system established does not include any precise, objective criteria, the legislation in issue goes beyond what is necessary in order to attain the objective indicated."<sup>87</sup>

As with the French legislation, the Belgian measures pursued the objective of the safeguarding of energy supplies in the event of a crisis, and hence constituted a matter of public security that can justify an obstacle to the free movement of goods and capital. In contrast to the French system, the legislation that was put in place by Belgium contained a number of limitations that the competent authorities had to adhere to. For instance, strict time limits were established, the regime was limited to certain decisions concerning the strategic assets of the companies in question, and an intervention was only admissible where there was a threat that the objectives of the energy policy may be compromised. Moreover,



such an intervention had to be supported by a formal statement of reasons and was subject to an effective review by the courts. It was for these limitations that the court found that the scheme “enables the member State concerned to intervene with a view to ensuring, in a given situation, compliance with the public service obligations incumbent on SNTC and Distrigaz, whilst at the same time observing the requirements of legal certainty.”<sup>88</sup> The Commission could not show that less restrictive measures could have been taken to attain the objective pursued. Consequently, the court held the Belgian legislation to be justified by the objective of guaranteeing energy supplies in the event of a crisis.<sup>89</sup>

#### 4. North American Free Trade Agreement (NAFTA)

To date, it appears that there is no case law concerning NAFTA article 2102 containing a national security exception. In addition, with regard to foreign investment, it appears unlikely that a NAFTA tribunal will review a party’s measure based on national security concerns prohibiting or restricting an investment by an investor of another party. Pursuant to article 1138.1 of NAFTA, a party’s decision under NAFTA article 2102 to prohibit or restrict the acquisition of an investment in its territory by an investor of another party, or its investment, is exempt from dispute settlement. Thus, in this respect, investors affected by such measures are not given a legal remedy to subject such measures to judicial review.

#### 5. Conclusion

To sum up, it can be observed that ICSID awards dealing with national security exception clauses in IIAs have not yet established a common approach. Broadly speaking, with the *LG&E* tribunal, the annulment committee in the *CMS* case, and the award in the *Continental Casualty* case on the one hand, and the *CMS*, *Sempra* and *Enron* tribunals on the other hand, two opposing approaches have been taken.<sup>90</sup>

Nonetheless, there seems to be broad agreement on two important issues. First, the scope of a national security exception may encompass situations of severe economic crisis, even though it is not clear what magnitude of crisis may be considered sufficient. Second, all tribunals have decided that a defence based on a clause such as the one in the Argentina–United States BIT is subject to judicial review and is not self-judging.

When the picture is broadened so that it also includes decisions by the ECJ and GATT/WTO panels and Appellate Body on national security clauses, some similarities can be observed and some interpretive guidance may be obtained.

Firstly, with regard to judicial review, all the tribunals and courts mentioned above have affirmed their competence – at least in principle – to review measures taken on national security grounds. Thus, it seems that a tribunal is, in general, not barred from reviewing such measures. In the case that a clause is considered to be self-judging, such as article XXI of the GATT, for which the wording is a strong indicator, the review is limited to a test of good faith. One important exception to this rule is NAFTA article 1138(1), since it exempts national security measures affecting investment from dispute settlement.

Secondly, when invoking non-self-judging clauses, every State has a certain margin of discretion with respect to which interest it considers to be fundamental and the degree of protection that it wants to provide. However, as discussed in the context of article XIV of the GATS and articles 46 and 58 of the EU Treaty, only measures that are objectively necessary may be taken. Broadly speaking, the WTO Appellate Body and the ECJ ask in this context whether or not there are other measures reasonably available which are less restrictive. The European Union (EU) – as a homogenous community that has reached a high standard of integration – applies strict conditions in this respect. By contrast, the *LG&E* tribunal, in interpreting article XI of the Argentina–United States

BIT, did not establish clear necessity requirements. Yet, it stated that a State has the freedom to choose between several responses.<sup>91</sup> Thus, it appears that the tribunal also applied a weighing and balancing test, and found the severity of the crisis to clearly justify the measures taken.

Thirdly, only recently a WTO panel and the Appellate Body broke new ground in interpreting the “public morals” and “public order” of GATS article XIV(a). There are some parallels with the interpretation of similar terms in the EU Treaty by the ECJ, which requires a genuine and sufficiently serious threat to a fundamental interest of society in order for the EU Treaty exception on the grounds of national security interests to be invoked.

Nevertheless, case law in this area is still in an early stage, and it is impossible to foresee how future tribunals will address these important issues. In particular, very limited case law seems to exist with regard to the question of the protection of strategic industries, and the existing jurisprudence concerns the special situation of regional integration. One possible way for IIA parties who wish to reduce the risks associated with unpredictable interpretation of a national security exception clause is to define their mutual understanding of its scope and its further implications, e.g. compensation. Some countries have already employed such a strategy with regard to other substantive treaty provisions, e.g. fair and equitable treatment and expropriation (UNCTAD, 2007b). However, it must be kept in mind that such an approach limits the regulatory flexibility of the parties in such a highly sensitive policy area as that of national security. The answer to the question of whether such a strategy should be adopted – and how it should be adopted – involves a number of factors to be balanced according to the preferences of each State (see chapter IV later in this text).

### Notes

- 
- <sup>1</sup> The relevant cases are: *CMS Gas Transmission Company v The Argentine Republic*, ICSID case no. ARB/01/08, award of 12 May 2005; *LG&E Energy Corp./LG&E Capital Corp./LG&E International Inc. v The Argentine Republic*, ICSID case no. ARB/02/1, award of 3 October 2006; *Enron Corporation Ponderosa Assets L.P. v The Argentine Republic*, ICSID case no. ARB/01/03, award of 22 May 2007; *Sempra Energy International v The Argentine Republic*, ICSID case no. ARB/02/16, award of 28 September 2007; *Continental Casualty Company v The Argentine Republic*, ICSID case no. ARB/03/9A, award of 5 September 2008. See also chapter I.D.1 of this paper.
- <sup>2</sup> *CMS Gas Transmission Company v The Argentine Republic*, ICSID case no. ARB/01/08, 12 May 2005, para. 359.
- <sup>3</sup> *CMS Gas Transmission Company v The Argentine Republic*, ICSID case no. ARB/01/08, 12 May 2005, para. 360.
- <sup>4</sup> *LG&E Energy Corp./LG&E Capital Corp./LG&E International Inc. v The Argentine Republic*, ICSID case no. ARB/02/1, 3 October 2006, para. 238.
- <sup>5</sup> *Continental Casualty Company v The Argentine Republic*, ICSID case no. ARB/03/9A, award of 5 September 2008, para. 175.
- <sup>6</sup> *CMS Gas Transmission Company v The Argentine Republic*, ICSID case no. ARB/01/08, 12 May 2005, para. 355.
- <sup>7</sup> *LG&E Energy Corp./LG&E Capital Corp./LG&E International Inc. v The Argentine Republic*, ICSID case no. ARB/02/1, 3 October 2006, para. 226.
- <sup>8</sup> *Continental Casualty Company v The Argentine Republic*, ICSID case no. ARB/03/9A, award of 5 September 2008, para. 180.
- <sup>9</sup> *Enron Corporation Ponderosa Assets L.P. v The Argentine Republic*, ICSID case no. ARB/01/03, 22 May 2007, para. 306; *Sempra Energy International v The Argentine Republic*, ICSID case no. ARB/02/16, 28 September 2007, para. 348.
- <sup>10</sup> *LG&E Energy Corp./LG&E Capital Corp./LG&E International Inc. v The Argentine Republic*, ICSID case no. ARB/02/1, 3 October 2006, para. 231–237.
- <sup>11</sup> *Ibid.*, para. 231.
- <sup>12</sup> *Continental Casualty Company v The Argentine Republic*, ICSID case no. ARB/03/9A, award of 5 September 2008, para. 180.
- <sup>13</sup> See chapter IV of this paper.
- <sup>14</sup> The threshold for what is considered as “critical” may differ from country to country. See the overview in “National security approaches to foreign

investment in ‘critical’ infrastructure” by OECD. Doc. no. DAF/INV/WD(2007) 21/REV1. 3 March 2008.

<sup>15</sup> See the discussion in UNCTAD (2008), chapters IV and V.

<sup>16</sup> See UNCTAD (2008 and 2006).

<sup>17</sup> Wharton School of the University of Pennsylvania (2007). “A closer look at sovereign wealth funds: secretive, powerful, unregulated and huge. Available at <http://knowledge.wharton.upenn.edu/category.cfm?cid=1>.

<sup>18</sup> Another argument put forward against foreign state funds is that their investments may result in a “nationalization” of domestic companies. This would run against the principle of market economies that are based on private entrepreneurship. Such “nationalization” would be particularly awkward if it affected domestic companies that had only recently, and possibly against serious internal opposition, been privatized. It should be noted that the term “nationalization” may be misleading in this context. “Nationalization” usually refers to the transfer of ownership of an investment to the *host country*, whereas in the case of SWFs, ownership is required by a *foreign public entity* in the host country. The two scenarios substantially differ from each other, because in the former case the host country becomes the sovereign owner of the property, while in the latter case the SWF remains subject to the host country’s laws and regulations.

<sup>19</sup> On the other hand, it has also been argued that foreign investment by SWFs creates more risks for the funds themselves than for the host countries in which they invest. SWFs would be in a weaker position than the host countries, because they could find themselves in a position where they become “hostages” of the host country. They would “only” acquire a legal right concerning the assets in which they invested, whereas the host country could exercise physical control over those assets if it wanted to. In the case of a conflict between the SWFs and the host country, the fact that the former held property rights in the company in which they invested would be of little value for the SWFs, since the host country could ignore those rights and seize the assets. An example would be the freezing by the host country of the bank accounts of foreign creditors, or the threat of an expropriation if the foreign investor does not behave in the way the host country wishes. SWFs would therefore expose themselves to a higher degree of risk than the host country. See *Neue Zürcher Zeitung*, 26 February 2008, page 27.

<sup>20</sup> The funds that are the most transparent in terms of their size, portfolio composition, and investment returns are those of Norway, Temasek, Alaska, Malaysia, Azerbaijan and Alberta (Canada). The least transparent funds are those of the United Arab Emirates, Kuwait, China, Qatar, Brunei, the

Bolivarian Republic of Venezuela, Taiwan Province of China, and Oman. See: Truman (2007).

<sup>21</sup> OECD Doc. no. DAF/INV(2008)5. 12 March 2008.

<sup>22</sup> See section I.D.1 of this paper.

<sup>23</sup> See several cases in connection with the Argentinian financial crises, section I.D of this paper.

<sup>24</sup> The Energy Charter Treaty and the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects were signed in December 1994, and entered into legal force in April 1998. To date, the Treaty has been signed or acceded to by 51 States, and by the European Community and Euratom (the total number of its members is therefore 53).

<sup>25</sup> ILC draft articles on the responsibility of States for internationally wrongful acts, with commentaries. United Nations General Assembly Official Records, Fifty-sixth session, Supplement No.10, Ch. 4, United Nations document A/56/10, art. 24, 25. Available at <http://untreaty.un.org/ilc/texts/instruments/english>.

<sup>26</sup> See also the Vienna Convention on the Law of Treaties, articles 60 and 62.

<sup>27</sup> Articles on the Responsibility of States for Internationally Wrongful Acts. United Nations document A/RES/56/83 (2001).

<sup>28</sup> 1997. International Court of Justice 7 at pages 51, 52 and 55.

<sup>29</sup> Report of the panel, Thailand: Restrictions on importation of and internal taxes on cigarettes, 75, DS10/R. 5 October 1990). GATT B.I.S.D. (Thirty-seventh suppl.) at 200, 222 (1990).

<sup>30</sup> O'Connor, J. *Good Faith in International Law*. 1991d.

<sup>31</sup> International Whaling Commission. Resolution 2001-01 (2001). Available at <http://www.iwcoffice.org/meetings>.

<sup>32</sup> For a discussion, see Bottini (2008).

<sup>33</sup> Lauterpacht, H. *The Function of Law in the International Community*, 1933, p.188.

<sup>34</sup> See in this connection, in particular, the jurisprudence of the European Court for Human Rights. In this respect: Mahoney, P. *Judicial Activism and Judicial Self-Restraint in the European Court of Human Rights: Two Sides of the Same Coin*. 11 Human Rights. L.J. 57, 78-80 (1990).; Macdonald, Ronald St. John. *The Margin of Appreciation Doctrine in the Jurisprudence of the European Court of Human Rights*. I-2 Collected courses of the Academy of European Law 95, 139-156 (Andrew Clapham, Frank Emmert, eds., 1990).

<sup>35</sup> The issue of essential security exceptions in connection with economic crisis has so far only been raised in cases against Argentina.

- <sup>36</sup> *CMS Gas Transmission Co. v The Republic of Argentina*. ICSID case no. ARB/01/8 (2005).
- <sup>37</sup> *Enron Corp. Ponderosa Assets v The Republic of Argentina*. ICSID case no. ARB/01/3 (2007).
- <sup>38</sup> *Sempra Energy International v The Argentine Republic*. ICSID case no. ARB/02/16. 28 September 2007.
- <sup>39</sup> *LG&E Energy Corp. et al. v The Republic of Argentina*. ICSID case no. ARB/02/1 (2006).
- <sup>40</sup> *Continental Casualty Company v The Argentine Republic*. ICSID case no. ARB/03/9A, award of 5 September 2008.
- <sup>41</sup> The relevant cases are mentioned in footnote 6.
- <sup>42</sup> As of September 2008, there are 33 pending cases against Argentina under the ICSID Convention, most of them relating to measures taken in the aftermath of the financial crisis.
- <sup>43</sup> In one of these cases (*Continental Casualty v Argentina*), the tribunal concluded that all but one of the measures taken by Argentina were covered by the national security exception.
- <sup>44</sup> *CMS Gas Transmission Company v The Argentine Republic*, ICSID case no. ARB/01/08, 12 May 2005, para. 317.
- <sup>45</sup> Treaty between the United States of America and the Argentine Republic concerning the reciprocal encouragement and protection of investment, signed 14 November 1991, entered into force 20 October 1994. Available at: [http://www.unctadxi.org/templates/DocSearch\\_\\_\\_779.aspx](http://www.unctadxi.org/templates/DocSearch___779.aspx)
- <sup>46</sup> International Law Commission. Draft articles on the responsibility of States for internationally wrongful acts, with commentaries. Available at [http://untreaty.un.org/ilc/texts/instruments/english/draft%20articles/9\\_6\\_2001.pdf](http://untreaty.un.org/ilc/texts/instruments/english/draft%20articles/9_6_2001.pdf). The text of this article is reproduced in chapter I.B.3.
- <sup>47</sup> *Sempra Energy International v The Argentine Republic*, ICSID case no. ARB/02/16, 28 September 2007, para. 376.
- <sup>48</sup> *CMS Gas Transmission Company v The Argentine Republic*, ICSID case no. ARB/01/08, 12) (annulment proceeding). Decision of the Ad Hoc Committee on the Application for Annulment of the Argentine Republic, 25 September 2007, para. 128–131.
- <sup>49</sup> *CMS Gas Transmission Company v The Argentine Republic*, ICSID case no. ARB/01/08, 12), (annulment proceeding). Decision of the Ad Hoc Committee on the Application for Annulment of the Argentine Republic, 25 September 2007, para. 136.
- <sup>50</sup> *LG&E Energy Corp./LG&E Capital Corp./LG&E International Inc. v The Republic of Argentina*, ICSID case no. ARB/02/1, 3 October 2006, para. 245:

“While the Tribunal considers that the protections afforded by Article XI have been triggered in this case, and are sufficient to excuse Argentina’s liability, the Tribunal recognizes that satisfaction of the state of necessity standards as it exists in international law (reflected in Article 25 of the ILC Draft Articles on State Responsibility) supports the Tribunal’s conclusion.”

- <sup>51</sup> Burke-White W and von Staden A. Investment protection in extraordinary times: the interpretation and application of non-precluded measures provision in bilateral investment treaties. *Virginia Journal of International Law*. 48 (2).
- <sup>52</sup> *Continental Casualty Company v The Argentine Republic*, ICSID case no. ARB/03/9A, award of 5 September 2008, para. 160–168.
- <sup>53</sup> Kurtz, Jürgen T. *ICSID Annulment Committee Rules on the Relationship between Customary and Treaty Exceptions on Necessity in Situations of Financial Crisis*. ASIL Insight, International Economic Law Edition, December 20, 2007, Volume 11, Issue 30. Available at: <http://www.asil.org/insights/2007/12/insights071220.html>
- <sup>54</sup> See chapter I.A.1.
- <sup>55</sup> See chapter IV.B.1.
- <sup>56</sup> *CMS Gas Transmission Company v The Argentine Republic*, ICSID case no. ARB/01/08, 12 May 2005, para. 370.
- <sup>57</sup> *Military and Paramilitary Activities In and Against Nicaragua* (Nicaragua v US), Merits, 1986 ICJ 14, 116.
- <sup>58</sup> *Oil Platforms* (Iran [Islamic Rep. of] v United States) 1996 ICJ 803, 20.
- <sup>59</sup> *Case concerning the Gabčíkovo-Nagymaros Project* (Hungary v Slovakia), 1997 ICJ 7.
- <sup>60</sup> *LG&E Energy Corp./LG&E Capital Corp./LG&E International Inc. v The Argentine Republic*, ICSID case no. ARB/02/1, 3 October 2006, para. 213.
- <sup>61</sup> *Enron Corporation Ponderosa Assets L.P. v The Argentine Republic*, ICSID case no. ARB/01/03, 22 May 2007, para. 335–339; *Sempra Energy International v The Argentine Republic*, ICSID case no. ARB/02/16, 28 September 2007, para. 379–388.
- <sup>62</sup> *Continental Casualty Company v The Argentine Republic*, ICSID case no. ARB/03/9A, award of 5 September 2008, para. 187.
- <sup>63</sup> *CMS Gas Transmission Company v The Argentine Republic*, ICSID case no. ARB/01/08, 12 May 2005, para. 388. Article 27(b) of the ILC Articles provides as follows: The invocation of a circumstance precluding wrongfulness in accordance with this chapter is without prejudice to...; (b) The question of compensation for any material loss caused by the act in question.



- <sup>64</sup> *LG&E Energy Corp./LG&E Capital Corp./LG&E International Inc. v The Argentine Republic*, ICSID case no. ARB/02/1, 3 October 2006, para. 264.
- <sup>65</sup> *CMS Gas Transmission Company v The Argentine Republic*, (ICSID case no. ARB/01/08, 12), (annulment proceeding), Decision of the Ad Hoc Committee on the Application for Annulment of the Argentine Republic, 25 September 2007, para. 146.
- <sup>66</sup> Article XIV(a) of the GATS is reproduced in section II.A of this paper. GATT Article XXI reads: “Nothing in this Agreement shall be construed (a) to require any Contracting Party to furnish any information the disclosure of which it considers contrary to its essential security interests; or (b) to prevent any Contracting Party from taking any action which it considers necessary for the protection of its essential security interests (i) relating to fissionable materials or the materials from which they are derived; (ii) relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment; (iii) taken in time of war or other emergency in international relations; or (c) to prevent any Contracting Party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.”
- <sup>67</sup> *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*. Report of the Panel, WT/DS285/R (10 November 2004), para. 6.461 and following.
- <sup>68</sup> Footnote no. 5 to this article reads: “The public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.”
- <sup>69</sup> *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*. Report of the Appellate Body, WT/DS285/AB/R (7 April 2005), para. 299.
- <sup>70</sup> For a discussion of necessity case laws see Neumann and Tuerk, 2003.
- <sup>71</sup> *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*. Report of the Panel, WT/DS285/R (10 November 2004), para. 6.477.
- <sup>72</sup> *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*. Report of the Panel, WT/DS285/R (10 November 2004), para. 6.531.
- <sup>73</sup> *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*. Report of the Appellate Body, WT/DS285/AB/R (7 April 2005), para. 309.

- <sup>74</sup> *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*. Report of the Appellate Body, WT/DS285/AB/R (7 April 2005), para. 372.
- <sup>75</sup> Contracting Parties, Third Session, Summary Record of the Twenty-second Meeting, Request of the Government of Czechoslovakia for a decision under Article XXIII as to whether or not the Government of the United States of America has failed to carry out its obligations under the Agreement through its administration of the issue of export licences, GATT/CP.3/SR.22 (8 June 1949), page 7.
- <sup>76</sup> See Hannes L. Schloemann and Stefan Ohloff, “Constitutionalizing” and Dispute Settlement in the WTO: National Security as an Issue of Competence, 93 AJIL (1999), 424, 432; Susan Rose-Ackerman and Benjamin Billa, *Treaties and National Security*, Yale Law School, page 18.
- <sup>77</sup> *United States – Trade Measures Affecting Nicaragua*, Report by the Panel, GATT Doc. L/6053, 13 October 1986, para.5.17.
- <sup>78</sup> Susan Rose-Ackerman and Benjamin Billa, *Treaties and National Security*, Yale Law School, page 21.
- <sup>79</sup> Relevant clauses are Articles 46, 58 EU Treaty provided in Chapter II C 2.
- <sup>80</sup> Namely article 58 (1)(b)). The text is reproduced in Chapter II C 2.
- <sup>81</sup> Case C-503/99 *Commission v Belgium* [2002] ECR I-4809, para. 45; Case C-483/99 *Commission v France* [2002] ECR I-4781, para. 45; Case C-367/98 *Commission v Portugal* para. 49.
- <sup>82</sup> Case C-483/99 *Commission v France* [2002] ECR I-4781, para. 46; Case C-367/98 *Commission v Portugal* para. 50.
- <sup>83</sup> Case C-367/98 *Commission v Portugal* para. 52.
- <sup>84</sup> Case C-483/99 *Commission v France* [2002] ECR I-4781, para. 47. In this context, the Court recalls its decision in Case C-72/83 *Campus Oil* [1984] ECR 2727, para. 35, where it found that “in the light of the seriousness of the consequences that an interruption in supplies of petroleum products may have for a country’s existence, the aim of ensuring a minimum supply of petroleum products at all times is to be regarded as transcending purely economic considerations and thus as capable of constituting an objective covered by the concept of public security.”
- <sup>85</sup> Case C-463/00 *Commission v Spain* [2003] ECR I-4581, para. 71.
- <sup>86</sup> Case C-483/99 *Commission v France* [2002] ECR I-4781, para. 48. See also: Case C-503/99 *Commission v Belgium* [2002] ECR I-4809, para. 47; Case C-463/00 *Commission v Spain* [2003] ECR I-4581, para. 72.
- <sup>87</sup> Case C-483/99 *Commission v France* [2002] ECR I-4781, para. 53.
- <sup>88</sup> Case C-503/99 *Commission v Belgium* [2002] ECR I-4809, para. 52.

- 
- <sup>89</sup> Case C-503/99 *Commission v Belgium* [2002] ECR I-4809, para. 55. Compare Case C-463/00 *Commission v Spain* [2003] ECR I-4581, para. 74 following, where the ECJ again found that too much discretion was assigned to the administrative authorities of Spain to exercise their right to approve or refuse certain share purchases.
- <sup>90</sup> This is also the view in scholarly writing. See: Burke-White W and von Staden A. Investment protection in extraordinary times: the interpretation and application of non-precluded measures provision in bilateral investment treaties. *Virginia Journal of International Law*. 48 (2): 70.
- <sup>91</sup> *LG&E Energy Corp./LG&E Capital Corp./LG&E International Inc. v The Argentine Republic*, ICSID Case No. ARB/02/1, 3 October 2006, para. 239–241.



## II. STOCKTAKING AND ANALYSIS

This section reviews the different formulations of national security exceptions that countries have chosen to use in IIAs. As will be seen, the language varies considerably. While some agreements include broad national security exceptions that aim at maximum State discretion in interpreting what constitutes a national security threat and what the measures to be taken in the face of such a threat are, other agreements have adopted a narrower approach, by listing the conditions under which the national security clause may be invoked. These conditions relate, for instance, to the non-discriminatory manner in which the measures must be applied, or they allow the exception to be invoked only in connection with specific sectors such as economic activities in the military or the trafficking of arms and ammunition. In a few IIAs, the national security exception applies with regard to specific treaty provisions only, rather than to the whole agreement (e.g. investor–State dispute settlement or expropriation). Some IIAs use a term other than “national security”, and permit deviation from the treaty obligations in serious crises such as war, natural disasters, financial crisis, acts of terrorism, or pandemic diseases. The formulation of each individual national security exception reflects the extent of discretion that Contracting Parties wish to retain for themselves when faced with a security threat.

As will be seen, negotiators and policymakers can choose from a variety of options available to them in order to protect themselves in the case of a serious crisis that could threaten their national or essential security. The findings can be summarized in three broad policy options used in IIAs. First, the Contracting Parties could opt to leave the exception out of the agreement altogether. In this case national security exceptions can still be invoked, but only through customary international law. A second option is to choose a narrow approach, whereby the parties list the conditions under which the exception can be invoked. With this approach, the parties can further narrow the scope of application of

the provision by avoiding using self-judging language. Finally, and in contrast to the second approach, the parties may wish to leave greater flexibility and discretion to themselves by opting for the self-judging clause “measures that *it considers necessary*” and avoiding listing the conditions under which the exception can be invoked.

While “national security” exceptions are included in only 12 per cent of the BITs reviewed, the majority of recent free trade agreements (FTAs) with investment provisions contain such an exception. Most of the BITs that include a national security exception were concluded by a small group of countries.<sup>1</sup> Interestingly, such exceptions can be found in BITs irrespective of whether the agreement is limited to the post-establishment phase or also covers the entry of foreign investment.

The issue of national security may become more important in future IIA negotiations, because there is an increasing number of States that are introducing or considering introducing national laws aimed at restricting foreign ownership for national security reasons and at securing greater Government control over strategic sectors such as natural resources and the extractive industries. In addition, many developing countries continue to face the risk of serious economic crisis, and even developed countries are not safe from this threat.

#### **A. The use of the term “essential security interests”, and related terms used in IIAs**

##### **1. “Essential security interests” and “national security”**

Most IIAs that include a security exception use the terms “essential security interests” or “national security” to describe a situation where the exception may be invoked. The Economic

Cooperation Agreement between India and Singapore (2005) is an example of the first alternative:

*Article 6.12:  
Security Exceptions*

1. *Nothing in this Chapter shall be construed:*
  - (a) *to require a Party to furnish any information, the disclosure of which it considers contrary to its **essential security interests**; or*
  - (b) *to prevent a Party from taking any action which it considers necessary for the protection of its **essential security interests**... (Emphasis added.)*

On the other hand, the BIT concluded between Hungary and the Russian Federation (1995) refers – among other crisis situations – to “national security”:

*Article 2:  
Promotion and reciprocal protection of investments*

3. *This Agreement shall not preclude the application of either Contracting Party of measures, necessary for the maintenance of defence, **national security** and public order, protection of the environment, morality and public health. (Emphasis added.)*

Do the terms “essential security interests” and “national security” address the same kind of situations, or is there a substantial difference between them? One could argue that “essential security interests” – by including the expression “essential” – is narrower than the more general term “national security”. However, it is far from obvious that Contracting Parties, by choosing one of these alternatives, actually intended to introduce such a distinction. This leaves it mainly to the arbitration tribunals to provide some further clarification of these terms.

## 2. Other terms used

### (a) *Public order*

Another approach is to refer to “public order” as a condition for invoking the security exception. The BIT between Belgium-Luxembourg and Guatemala (2005) is a case in point:

*Article 3*

*Protection of investments*

*1. All investments, whether direct or indirect, made by investors of one Contracting Party shall enjoy a fair and equitable treatment in the territory of the other Contracting Party. Except for measures required to **maintain public order**, such investments shall enjoy continuous protection and security, i.e. excluding any unjustified or discriminatory measure which could hinder, either in law or in practice, the management, maintenance, use, possession or liquidation thereof. (Emphasis added.)*

As explained in section I.D of this paper, the meaning of the concept of “public order” is subject to interpretation, and there currently exists only limited international case law that could help in clarifying the term. There is also the question of how “public order” relates to “national security”, i.e. whether a public order exception covers any kind of threat to national security, or whether it is more directed towards disturbances of the internal legal order.

The BIT concluded between Japan and the Republic of Korea (2002) clarifies in greater detail what is meant by “public order”. The agreement provides that the exception may only be invoked where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society:



*Article 16*

1. *Notwithstanding any other provisions in this Agreement ... each Contracting Party may:*
- (a) take any measure which it considers necessary for the protection of its essential security interests;*
  - (i) taken in time of war, or armed conflict, or other emergency in that Contracting Party or in international relations; or*
  - (ii) relating to the implementation of national policies or international agreements respecting the non-proliferation of weapons;*
  - (b) take any measure in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security;*
  - (c) take any measure necessary to protect human, animal or plant life or health; or*
  - (d) **take any measure necessary for the maintenance of public order. The public order exceptions may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.***  
(Emphasis added.)

In common with other examples already cited, this provision once again makes an important distinction concerning its self-judging nature. Whereas with regard to the protection of essential security interests each Contracting Party has the right to determine on its own what measure it considers necessary to respond to the threat, only such action that is *objectively required* is allowed for the maintenance of public order.

The above example is also interesting for another reason. The provision explicitly distinguishes between cases where the essential security interests of a Contracting Party are at stake and those where there is a threat to public order. This means that IIA

Contracting Parties do not consider the idioms “essential security interests” and “public order” as synonyms.

The “public order” of a country may be affected in the case of a severe economic crisis that results in civil unrest or similar disturbances. The question also arises of whether a Contracting Party’s measures to protect its strategic industries could likewise be justified by a public order exception. At least in the above example, the threshold for invoking the exception is high, since the country concerned would have to demonstrate that a foreign takeover of a domestic strategic industry would pose a genuine and sufficiently serious threat to one of the fundamental interests of society.

*(b) Extreme emergency*

Another approach is to refer to “circumstances of extreme emergency” as an additional justification for invoking the exception. Most BITs concluded by India illustrate this approach. A case in point is the BIT concluded between Egypt and India (1997):

*Article 11 (2)*

*Notwithstanding 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.<sup>2</sup> (Emphasis added.)*

Once again there is the question of how to distinguish this concept from a scenario in which the essential security interests of

a party are concerned. In other words: when could there be an extreme emergency that is unrelated to a threat to a country's essential security interests? Such emergency scenarios may include very serious financial, economic or political crises, natural disasters or the spread of epidemics. Civil disobedience, riots and similar events that remain below the threshold of a threat to a country's essential security interests could likewise be covered.

*(c) Public morals*

In some IIAs, the parties also refer to public morals. This considerably broadens the scope of the security clause. The BIT between Egypt and the United States (1986) includes such a provision:

*Article X*

*Measures not precluded by treaty*

*1. This Treaty shall not preclude the application by either Party or any subdivision thereof of any and all measures necessary for the maintenance **of public order and morals**, the fulfillment of its existing international obligations, the protection of its own security interests, or such measures deemed appropriate by the Parties to fulfill future international obligations.*  
(Emphasis added.)

The definition of what constitutes a breach to public morality very much depends on cultural traditions and religion, which may substantially differ between countries and regions. Therefore, IIA Contracting Parties may have divergent opinions when assessing whether there is a threat to public morals. The exception could apply, for instance, in individual sectors, such as the media, in order to prohibit pornographic material or other "immoral" publications.

With regard to each of the subsections above – (a), (b), (c) and (d) – IIA Contracting Parties have to decide whether they want to keep the term (e.g. “public order” or “extreme emergency”) undefined, or whether they prefer to include some further clarifications. There are different approaches, and the level of clarity and precision varies from one agreement to the other. Where greater detail exists, the Contracting Parties might find it more difficult to invoke the security exception, while a more open approach leaves considerable room for interpretation of what constitutes a reasonable condition for invoking the national security exception. On the other hand, the use of a broad and open-ended term reduces legal clarity and predictability. Achieving the “right” balance between preserving sufficient discretion for Contracting Parties on the one hand, and providing appropriate investment protection on the other hand, can become a major challenge for IIA negotiators (see section IV).

*(d) International peace and/or security*

Some IIAs list obligations in respect of international peace and security as a separate justification for invoking the security exception. This provision allows the parties to invoke the national security exception in the case of an international conflict where they have an obligation to maintain or restore security, even if the conflict does not directly threaten the national security of the parties. It therefore broadens the scope of the security exception.

IIAs have adopted two approaches in this respect. Some agreements refer to “peace *or* security”, while others refer to “peace *and* security”. The BIT concluded between the United States and Uruguay (2005) is an illustration of the first approach:

*Article 18:  
Essential Security*

*Nothing in this Treaty shall be construed:*

...  
2. to preclude a Party from applying measures that it considers necessary for the fulfillment of its **obligations with respect to the maintenance or restoration of international peace or security**, or the protection of its own essential security interests.<sup>3</sup> (Emphasis added.)

The second approach is used in the Economic Partnership, Political Coordination and Cooperation Agreement concluded between the EU and Mexico (2000):

*Article 52*

*National security clause*

*No provision of this Agreement shall preclude a Party taking measures:*

...  
(c) *which it considers essential to its security in the event of serious domestic disturbances liable to jeopardize public order, of war or serious international tensions that might erupt into armed conflict or **to fulfil obligations it has entered into for the maintenance of peace and international security***. (Emphasis added.)

There is the issue of whether there is any substantial difference between the text options “and” and “or”. It appears that the first alternative – by requiring that the maintenance of both international peace and security be at stake – is narrower than the second approach, under which the exception can be invoked if either international peace or security are threatened. In practice, however, it is difficult to imagine a situation where this distinction could become relevant.

It should be noted that if the United Nations Security Council adopted a resolution under Chapter VII of the United Nations Charter, requiring a party to an IIA to take a measure in

the interest of international peace and security, that party would not be in breach of the IIA if it so acted, even if the IIA contained no national security exception in respect of international peace and security. Chapter VII declarations are binding on all States, and obligations under the Charter override treaty obligations (Article 103).

***(e) Measures related to the production, trade and development of arms and other defence material***

Some IIAs, in addition to listing security concerns, include a specific exception relating to the production, trade and development of arms and other defence material. The Association Agreement between Egypt and the European Union (2001) is an illustration:

*Article 83*

*Nothing in this Agreement shall prevent a Party from taking any measures:*

...

***(b) which relate to the production of, or trade in, arms, munitions or war materials or to research, development or production indispensable for defence purposes, provided that such measures do not impair the conditions of competition in respect of products not intended for specifically military purposes;***

*(c) which it considers essential to its own security in the event of serious internal disturbances affecting the maintenance of law and order, in time of war or serious international tension constituting threat of war or in order to carry out obligations it has accepted for the purpose of maintaining peace and international security.<sup>4</sup> (Emphasis added.)*

This approach is common to the agreements concluded by the European Community with third parties. It should be noted that the above text introduces a distinction concerning the self-judging nature of the provision. Whereas with regard to the production and trade of arms etc. any measure may be taken which is objectively related to the threat (see subparagraph (b) above), Contracting Parties are free to make a subjective assessment as to what measures they consider essential in order to respond to serious internal disturbances and international conflicts (see subparagraph (c) above).

On the other hand, the discretion of the Contracting Parties is limited insofar as the provision exhaustively lists the cases that may constitute a threat to the internal order or to international peace. The list is drawn relatively narrowly, and it does not, for instance, include a situation where a Contracting Party seeks to protect its strategic industries from foreign takeovers.

## **B. Conditions for invoking a security-related exception in IIAs**

### **1. No arbitrary or unjustifiable discrimination**

The vast majority of IIAs that include a “national security” exception condition the application of the provision in one way or another. One of the most common conditions is that the measure must not be arbitrary or constitute an unjustifiable discrimination. The Economic Partnership Agreement between Japan and the Philippines (2006) is an illustration:

*Article 99**General and Security Exceptions*

1. 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**, or a disguised restriction on investments of investors of the other Party in the Area of a Party, nothing in this Chapter other than Article 96 [protection from strife] shall be construed to prevent a Party from adopting or enforcing measures:

(a) necessary to protect human, animal or plant life or health;

(b) necessary to protect public morals or to maintain public order;

*Note: The public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.*

(c) which it considers necessary for protection of its essential security interests;

(i) taken in time of war, or armed conflict, or other emergency in that Party or in international relations; or

(ii) relating to the implementation of national policies or international agreements respecting the non-proliferation of weapons;

(Emphasis added.)

Other IIAs clarify that the measures adopted by the parties should, in addition to being applied on a non-discriminatory basis, be in accordance with their domestic laws. The BIT between Hungary and India (2003) is an example:



*Article 12*  
*Applicable Laws*

*2. Notwithstanding 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.)*

By including language ensuring the non-discriminatory application of the “national security” exception, the Contracting Parties provide a guarantee to foreign investors that the host State will pay attention to a basic rule of law. While this condition still leaves ample regulatory freedom for Contracting Parties, foreign investors can at least be sure that the host country must be able to give an explanation and justification for an investment restriction imposed for security reasons, and that its application is independent of the nationality of the investor.

**2. Disguised restriction of investment or trade**

IIAs including the condition of non-arbitrariness usually also provide that the host State will not use the exception as a disguised restriction on trade or investment. The Association of Southeast Asian Nations (ASEAN) investment agreements typically adopt this approach. The Framework Agreement on the ASEAN Investment Area (1998) is a case in point:

*Article 13*  
*General Exceptions*

*Subject 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.)

Whereas in the above example the emphasis is on investment restrictions, other IIAs focus on trade. An illustration is the Framework Agreement between ASEAN and China (2003):

*Article 10*  
*General Exceptions*

*Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between or among the Parties where the same conditions prevail, or a **disguised restriction on trade** within the China–ASEAN FTA, nothing in this Agreement shall prevent any Party from taking and adopting measures for the protection of its national security. (Emphasis added)*

This approach ensures that the host State will not be able to use the exception to derogate from its treaty obligation in a sporadic manner or to take protectionist measures under the pretext of a security threat. This condition may be particularly important in a case where a host country seeks to protect its strategic industries from foreign takeovers.

---

### 3. Listing of cases in which there may be a threat to “essential security interests”

A number of IIAs limit the scope of application of the national security exception by enumerating the specific categories of cases in which the clause may be invoked. This approach is more common in free trade agreements than in bilateral investment treaties. A possible explanation is that when negotiating a BIT, the parties consider investment protection to be their main objective, whereas in FTAs a more integrated approach is adopted, which may possibly allow more scope for drafting security exceptions that also cover trade. Moreover, FTAs often contain provisions concerning the establishment of foreign investment – an area that may be particularly sensitive from the point of view of security.

The categories of cases included in these IIAs are similar, but they vary in their detail. Three main groups can be distinguished:

- Trafficking in arms;
- War and other emergencies in international relations;
- Policies concerning the non-proliferation of nuclear weapons.

It should be noted that each of these cases relates to a situation where some kind of military threat or the production or supply of weapons and other military equipment is at stake. This implies that these kinds of security exceptions are not applicable with regard to economic crisis or the protection of strategic industries.

The North American Free Trade Agreement (1992) illustrates this approach:

*Article 2102: National Security*

1. Subject to Articles 607 (Energy – National Security Measures) and 1018 (Government Procurement Exceptions), nothing in this Agreement shall be construed:

...

(b) to prevent any Party from taking any actions that it considers necessary for the protection of its essential security interests

(i) relating to **the traffic in arms, ammunition and implements of war and to such traffic and transactions in other goods, materials, services and technology undertaken directly or indirectly for the purpose of supplying a military or other security establishment,**

(ii) **taken in time of war or other emergency in international relations,** or

(iii) relating to the implementation of national policies or international agreements respecting **the non-proliferation of nuclear weapons or other nuclear explosive devices;** or

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

The General Agreement on Trade in Services (GATS) (1994) includes a similar provision:

*Article XIV bis:*

1. Nothing in this Agreement shall be construed:

...

(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.<sup>5</sup> (Emphasis added.)*

A variation of this approach clarifies that the list of conditions is not exhaustive, and that the national security exception may be invoked also under conditions that are not explicitly mentioned. The Closer Economic Partnership Agreement between New Zealand and Singapore (2000) is an example:

*Article 76*  
*Security*

*Nothing in this Agreement shall be construed:*

*(a) as preventing either Party from taking any action which it considers necessary for the protection of its essential security interests, **including but not limited to** action relating to 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, and any action taken in time of war or other emergency in domestic or international relations;*  
*(Emphasis added.)*

Another method occasionally found in IIAs is also to refer to *serious internal disturbances*. Under this approach, a serious internal disturbance affecting the maintenance of law and order is listed as one of the cases that may constitute a threat to a Contracting Party's own security. An example would be riots, but also serious financial and economic crisis that affect law and order. The Association Agreement between the EU and Egypt (2001) is an illustration:

*Article 83*

*Nothing in this Agreement shall prevent a Party from taking any measures:*

...

*(b) which relate to the production of, or trade in, arms, munitions or war materials or to research, development or production indispensable for defence purposes, provided that such measures do not impair the conditions of competition in respect of products not intended for specifically military purposes;*

*(c) which it considers essential to its own security in the event of **serious internal disturbances** affecting the maintenance of law and order, in time of war or serious international tension constituting threat of war or in order to carry out obligations it has accepted for the purpose of maintaining peace and international security.<sup>6</sup> (Emphasis added.)*

Under the "comprehensive listing" approach, the Contracting Parties may only take measures for national security reasons if at least one of the conditions listed above applies. This limits the scope of application of the provision, hence increasing legal certainty and predictability by making it more difficult for parties to invoke the clause. For instance, under a comprehensive listing approach, countries may be barred from adopting measures to protect their strategic industries.

The comprehensive listing approach also tends to be more restrictive when it comes to the question of how concrete an *external threat* to national security has to be for the Contracting Parties to invoke the exception. The above examples allow recourse to the clause only in times of war or other emergency situations. This means that a severe crisis must already be there. By contrast, the approach referring to a threat to national security in general gives Contracting Parties more leeway, including in respect of their assessment of how manifest a crisis must be before a country may respond to it.

However, even in the case of exhaustively listing the conditions necessary for invoking the security exceptions, the parties usually still maintain a considerable degree of flexibility in deciding how to respond to the threat. The reason is that almost all the examples above give Contracting Parties full discretion to take those measures that *they consider* necessary. Thus, while the interpretative space is reduced with regard to the term “essential security interests”, this is not the case in respect of the question of how Contracting Parties may respond to such a threat. In addition, even with regard to the existence of a threat to national security, the comprehensive listing approach does not reduce the Contracting Parties’ discretion completely. At least some of the terms used in the examples above to clarify the meaning of “essential security interests” are themselves rather vague and open to interpretation. For instance, Contracting Parties retain discretion to assess what is meant by “crisis or emergency in international relations”, leaving such concepts to be clarified on a case-by-case basis.

#### **4. Conformity with other international rules**

Another technique is to require that any measures taken for the protection of national security be in accordance with other international obligations of the Contracting Parties. The

Framework Agreement between ASEAN and Japan (2003) is an example:

*Article 8*  
*General exceptions*

*Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between or among Japan and ASEAN where the same conditions prevail, or a disguised restriction on trade within the Japan–ASEAN CEP [Closer Economic Partnership], nothing in this Framework should prevent Japan and/or any individual ASEAN Member State from adopting or enforcing measures, **in accordance with the rules and disciplines of the WTO Agreement**, for: (a) **the protection of the national security of Japan and/or each ASEAN Member State**, (Emphasis added.)*

This approach has the important effect of clarifying how the exception clause in the IIA relates to obligations of the Contracting Parties contained in other international agreements. In general, national security exceptions aim at freeing Contracting Parties from any kind of international obligations in respect of the investment. The above example makes it clear that existing WTO obligations remain applicable.

##### 5. Necessity of the host country response

As explained in section I.C.1, probably the single most important issue concerning a national security clause is the extent to which the Contracting Parties are free to decide how they want to respond to a perceived threat to their essential security interests. This relates to the question of the self-judging nature of the



security clause. Ample discretion in this regard is clearly in the interest of the host country, but it may come at the expense of investment protection. Four basic approaches can be distinguished in IIA practice:

*(a) Self-judging clauses*

One method is to leave it completely to the discretion of the host country as to what kind of measure it considers necessary to respond to a security threat. This is the technique that gives the highest degree of autonomy to the Contracting Parties. Most IIAs including a national security exception contain language to this effect.

Cases in point for such a maximum degree of discretion are a number of BITs concluded by the United States. They contain no specific limitations or conditions for invoking the national security exception besides the requirement that the relevant Contracting Party must consider the measure “necessary”. The BIT between the United States and Uruguay (2005) provides an example:

*Article 18  
Essential Security*

*Nothing in this Treaty shall be construed:*

...

*2. to preclude a Party from applying measures that **it considers necessary** for 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.)

The only obligation Contracting Parties have when such language is used in IIAs is to abide by the general principles of article 26 of the Vienna Convention on the Law of Treaties (1969),

according to which States have to carry out their obligations in “good faith”.<sup>7</sup> However, it may be difficult to judge in an objective manner whether a Contracting Party has invoked the national security exception in “good faith” or not. Critiques of including exceptions of a self-judging nature in IIAs, therefore, see it as a too easy way of escaping from the obligations of the treaty.<sup>8</sup>

A variation in the use of a self-judging national security exception is to limit its applicability to specific categories of situations. The Economic Partnership Agreement between Chile and Japan (2007) is an illustration:

*Article 193  
Security Exceptions*

*Nothing in this Agreement other than Article 76 shall be construed:*

...

*(b) to prevent a Party from taking any actions **which it considers necessary** for the protection of its essential security interests:*

*(i) relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials, or such supply of services, as is carried on directly or indirectly for the purpose of supplying or provisioning a military establishment;*

*(ii) taken in time of war or other emergency in international relations; or (iii) relating to fissionable and fusionable materials or the materials from which they are derived;<sup>9</sup>*

(Emphasis added.)

*(b) Necessity as objective precondition*

By contrast, the second basic approach requires necessity as an *objective precondition* for invoking the clause. It is no longer

the subjective assessment of the host country that matters. The BIT between Bulgaria and the United States (1992) is an example:

*Article X*

*1. This 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.)*

Under the above approach, arbitration tribunals would have the power to judge whether the respective host country measure was indeed required to respond to the threat, or whether there would have been less severe means with a smaller impact on the investment. The approach would thus allow for a proportionality test. This reduces the regulatory discretion of the Contracting Parties considerably, but it also enhances legal clarity and predictability for the foreign investor.

This may become important, for instance, in respect of host country measures aimed at protecting its strategic industries or at responding to an economic crisis. Under a self-judging clause, it would be difficult to challenge a host country's assessment that the closing of these sectors to foreigners is necessary in order to protect its essential security interests. Whether foreigners are allowed to invest in industries considered by the host country as strategic is primarily a political decision, and it is exactly the purpose of a self-judging clause to ensure that political considerations prevail over legal scrutiny. All a tribunal could do in this case would be to investigate whether the protection of strategic industries falls under the scope of a national security exception and whether the country concerned has acted in good faith, that is to say, whether there are any reasonable explanations

for why the country considers a foreign takeover to be a security threat. If, however, “necessity” were an objective criterion, then it would become more difficult for the host country to prevail with its view, because it would have to prove that no less severe measures were available to protect its strategic industries. Likewise, when it came to economic crisis, a self-judging clause would imply that a tribunal was confined to assessing whether an economic crisis qualified as a threat to national security or not, and whether the host country had acted in good faith by invoking the clause. However, the tribunal would not be in a position to examine whether the measures taken by the host country were actually necessary to tackle the crisis.

*(c) No reference to “necessity”*

The third method is to give up the requirement of necessity and to regard it as sufficient that the measure taken relates to national security. This approach increases the regulatory freedom of Contracting Parties; it also allows them a subjective appraisal of what kind of measure they consider appropriate, as long as it is directed towards the protection of the national security. A case in point is the BIT between Hungary and India (2003):

*Article 12  
Applicable Laws*

*2. ... 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.<sup>10</sup> (Emphasis added.)*

Another illustration of this approach is the BIT between Peru and Singapore (2003):

*Article 11*  
*Prohibitions and Restrictions*

*The provisions of this Agreement shall not in any way limit the right of either Contracting Party to apply prohibitions or restrictions of any kind or take any other action **which is directed** to the protection of its essential security interests, or to the protection of public health or the prevention of diseases and pests in animals or plants.*  
(Emphasis added.)

Although the two examples above establish objective conditions for invoking the exception, their practical effect comes very close to a self-judging clause. Only in extreme cases will an arbitral tribunal conclude that the host country measure has no relation whatsoever to the national security interests of a party.

*(d) Exclusion of judicial review*

The final approach is to exclude a judicial review of the invocation of the national security exception. This method gives Contracting Parties the highest degree of autonomy, because they do not have to be concerned that an arbitration tribunal may examine the legality of their security-related measures and may declare them illegal. This technique is extremely rare in IIAs. One example is the Comprehensive Economic Cooperation Agreement between the Republic of India and the Republic of Singapore (2005).

*Article 6.12*  
*Security Exceptions*

*4. This 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.* (Emphasis added.)

The extent to which self-judging exceptions free Contracting Parties from judicial review also depends on the interaction with other requirements for invoking the clause. In conjunction with a broad, open-ended use of the term “national security” in IIAs, a self-judging exception gives the maximum discretion that Contracting Parties can possibly reserve for themselves in the agreement. By contrast, discretion is reduced if the exception defines the term “national security” in more detail, or contains other conditions for having recourse to it. Also, it would be possible to combine a broadly defined notion of “national security” with the non-self-judging character of the provision; and, vice versa, a narrow definition could go along with a self-judging clause.

### **C. Security-related exceptions in relation to specific IIA provisions**

#### **1. Specific exception clause as an alternative to a general clause**

National security exceptions do not always exempt Contracting Parties from all obligations they have assumed under the IIA. Sometimes, the exception only applies with regard to specific treaty provisions, rather than to the whole agreement. In this case, the exception does not appear as a separate article in the IIA, but only as a subparagraph in the provision to which it refers (e.g. expropriation or investor-State dispute settlement).

##### ***(a) The right of establishment***

IIAs including a right of establishment for foreign investors sometimes contain a specific security exception in this

respect. This takes account of the fact that if security problems arise in connection with a foreign investment, they are mostly related to its admission in the host country. An example of this approach is the Treaty Establishing the European Community (consolidated version of 2002).

*Chapter 2  
Right of Establishment*

*Article 43*

*Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.*

*Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 48, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the chapter relating to capital.*

...

*Article 46*

***1. The provisions of this chapter and measures taken in pursuance thereof shall not prejudice the applicability of provisions laid down by law, regulation or administrative action providing for special treatment for foreign nationals on grounds of public policy, public security or public health.*** (Emphasis added.)

It should be noted that this provision uses the formulation “public security” and not “national security”. “Public security” might be the broader term, as it may also cover scenarios where the security threat does not reach the national level, but is limited to a local or regional event.

***(b) Non-discrimination***

Another possibility is to lodge a security exception only in relation to the non-discrimination principle. Accordingly, some IIAs clarify that measures taken for reasons of public security and similar concerns are outside of the scope of application of the national treatment and most-favoured-nation treatment standards. This approach is often adopted in German BITs.<sup>11</sup> The BIT between China and Germany (2003) is an illustration:

*Article 3*

*Treatment of Investment*

*(1) Investments of investors of each Contracting Party shall at all times be accorded fair and equitable treatment in the territory of the other Contracting Party.*

*(2) Each Contracting Party shall accord to investments and activities associated with such investments by the investors of the other Contracting Party **treatment not less favourable than that accorded to the investments and associated activities by its own investors.***

*(3) Neither Contracting Party shall subject investments and activities associated with such investments by the investors of the other Contracting Party to **treatment less favourable than that accorded to the investments and associated activities by the investors of any third State.***

(Emphasis added.)



In addition, the Protocol provides that:

*4. Ad Article 3*

...

*The following shall, in particular, be deemed “treatment less favourable” within the meaning of Article 3: unequal treatment in the case of restrictions on the purchase of raw or auxiliary materials, of energy or fuel or of means of production or operation of any kind as well as any other measures having similar effects. **Measures that have to be taken for reasons of public security and order, public health or morality shall not be deemed “treatment less favourable” within the meaning of Article 3.** (Emphasis added.)*

*(c) Transfer of funds*

A further technique is to provide for a security exception in relation to the IIA provision on the transfer of funds. Such an exception clause needs to be distinguished from a so-called “balance of payments” provision as can be found in many IIAs, and which allows temporary restriction of transfers in connection with an investment in the specific situation of a balance of payments crisis. The Treaty Establishing the European Community is, once again, an example of such a security exception:

*Chapter 4  
Capital and Payments*

*Article 56*

*1. 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.*

*Article 58*

1. *The provisions of Article 56 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.* (Emphasis added.)

The question is whether the above provision – despite the fact that it does not explicitly address a balance of payments crisis – would nevertheless be applicable in such a situation. This does not seem to be the case, as the Treaty establishing the European Community contains separate provisions on this issue (articles 59, 119 and 120).

*(d) Investor-State dispute settlement*

Some BITs include language aimed at excluding fully or partially the investor-State dispute settlement mechanism concerning measures adopted by the Contracting Parties for national security reasons. Within the scope of this carve-out, the parties therefore cannot be held accountable by international tribunals for actions or measures they have taken to defend their security interests.

The BIT between Mexico and the Netherlands (1998) is an example of a broad approach concerning the exclusion of investor-State dispute settlement. It rules out investor-State dispute settlement with regard to any measure that a Contracting Party has taken for reasons of national security:

*Article 12  
Exclusions*

*The dispute settlement provisions of this Schedule shall not apply to the resolutions adopted by a Contracting Party for national security reasons.*  
(Emphasis added.)

A more limited approach is to exclude investor–State dispute settlement procedures only in respect of measures related to the *acquisition of a domestic enterprise* by a foreign investor. The BIT between Iceland and Mexico (2005) is an example:<sup>12</sup>

*Article 23  
Exclusions*

*The dispute settlement provisions of Chapter Two shall not apply to the resolutions adopted by a Contracting Party which, for national security reasons, prohibit or restrict the acquisition of an investment in its territory, owned or controlled by its nationals, by investors of the other Contracting Party, according to the legislation of each Contracting Party.*  
(Emphasis added.)

The above approach raises the question of the extent to which an arbitration tribunal would be barred from reviewing the legality of an investment restriction taken for security reasons. One could argue that it would be sufficient if the Contracting Party concerned declared the measure to be security-related. In support of this view, one could make the point that the provision contains the qualification “according to the legislation of each Contracting Party” and that the purpose of this reference would be to confirm the sovereign right of the parties to decide on their own whether the national security is at risk. On the other hand, the provision does not include the typical “self-judging” language, which might

be an indication that arbitral tribunals still have the right to review whether the prohibition or restriction was indeed security-related.

## **2. Specific security exception in addition to a general clause**

There are also some IIAs that include a specific security exception clause relating to individual issues in addition to the general security exception in the agreement.

### ***(a) Transparency***

Most IIAs under review that include a general security exception also contain a provision clarifying that nothing in the agreement shall require a Contracting Party to allow access to any information the disclosure of which may be contrary to its essential security interests. Such an exception clause may be particularly relevant if the IIA includes an explicit transparency obligation. The exception does not deal with investment restrictions imposed for security reasons, but only affirms the rights of the parties not to give access to certain information that could affect its essential security interests. The free trade agreement between Australia and Singapore (2003) is a case in point:<sup>13</sup>

*Article 20*  
*Security Exceptions*

*Nothing in this Chapter shall be construed:*

***(a) to require a Party to furnish any information, the disclosure of which it considers contrary to its essential security interests;*** (Emphasis added.)

Another approach is to restrict the disclosure of sensitive information only in respect of *investor-State dispute settlement*. In this case, the provision aims at limiting transparency in arbitral proceedings if the disclosure of such information could constitute a threat to the national security of a Contracting Party. The parties

are no longer bound to make available to the public certain information relating to the notice of intent, the notice of arbitration, pleadings, memorials, and briefs submitted to the tribunal if withholding such information is deemed necessary for the protection of their national security. The free trade agreement between the Republic of Korea and the United States (2007) provides an example:

*Article 11.21:*

*Transparency of Arbitral Proceedings*

*1. Subject to paragraphs 2, 3, and 4, the respondent shall, after receiving the following documents, promptly transmit them to the non-disputing Party and make them available to the public:*

*(a) the notice of intent;*

*(b) the notice of arbitration;*

*(c) pleadings, memorials, and briefs submitted to the tribunal by a disputing Party and any written submissions submitted pursuant to Article 11.20.4 and 11.20.5 and Article 11.25;*

*(d) minutes or transcripts of hearings of the tribunal, where available; and*

*(e) orders, awards, and decisions of the tribunal.*

*2. The tribunal shall conduct hearings open to the public and shall determine, in consultation with the disputing parties, the appropriate logistical arrangements. However, any disputing Party that intends to use information designated as protected information in a hearing shall so advise the tribunal. The tribunal shall make appropriate arrangements to protect the information from disclosure.*

*3. **Nothing in this Section requires a respondent to disclose protected information or to furnish or allow access to information that it may withhold in accordance with Article 23.2 (Essential Security) or Article 23.4 (Disclosure of Information).*** (Emphasis added.)

*(b) Entry of business visitors*

In rare cases, IIAs include a specific “national security” exception concerning the entry of foreign nationals in connection with an investment. This provision aims at reducing the risk of unwanted citizens deemed dangerous for the “national security” entering the territory of the other Contracting Party in the guise of business persons. The exception underlines the parties’ discretion as to the entry of foreign nationals in their territory, even if they are business visitors or investors of the other party. The free trade agreement between India and Singapore (2005) is an illustration:

*Article 9.3:*

*General principles for grant of temporary entry*

1. Each Party **shall grant temporary entry to natural persons of other Party**, who are otherwise qualified for entry under applicable measures relating to public health and safety and **national security**, in accordance with this Chapter [Movement of natural persons]. (Emphasis added.)

A similar provision can be found in the FTA between Panama and Singapore (2006):

*Annex 10 A*

*Movement of Business Persons*

*Article 3*

*Intra-Corporate Transferees*

*A Party shall grant temporary entry to an intra-corporate transferee of the other Party who otherwise meets its criteria for the grant of an immigration formality unless there has been a breach of any of the conditions governing temporary entry, or an application for an extension of an immigration formality has been refused on **such grounds***

---

*of national security or public order by the granting Party as it deems fit ... (Emphasis added.)*

#### **D. Non-applicability of a security-related exception with regard to individual IIA provisions**

A few IIAs exclude certain provisions from the scope of application of the “national security” exception. Thus, this approach limits the right of Contracting Parties to invoke the security exception. They are, in principle, allowed to have recourse to the exception; however, this possibility is excluded with regard to specific aspects of investment protection. While this technique is therefore different from the approach described in section C, the objective is similar – to restrict a country’s room for manoeuvre and to give more legal security to foreign investors.

All examples that could be found in this category declare the security exception inapplicable with regard to the provisions on expropriation or compensation for losses. As a result, the parties may still expropriate a foreign investor for security reasons, but they cannot derogate from their obligation to pay appropriate compensation. Likewise, in case of investor losses due to war or civil strife, the obligation to provide non-discriminatory treatment concerning compensation payments by the host country remains intact. The Energy Charter Treaty (1994) is an illustration:<sup>14</sup>

*Article 24  
Exceptions*

*(1) This Article shall not apply to Articles 12 (Compensation for losses), 13 (Expropriation) and 29 (Interim provisions on trade related matters)*

...

*(3) The provisions of this Treaty other than those referred to in paragraph (1) shall not be construed to prevent any*

*Contracting Party from taking any measure which it considers necessary:*

*(a) for the **protection of its essential security interests** including those*

*(i) relating to the supply of Energy Materials and Products to a military establishment; or*

*(ii) taken in time of war, armed conflict or other emergency in international relations;*

*(b) relating to the implementation of national policies respecting the non-proliferation of nuclear weapons or other nuclear explosive devices or needed to fulfil its obligations under the Treaty on the Non-Proliferation of Nuclear Weapons, the Nuclear Suppliers Guidelines, and other international nuclear non-proliferation obligations or understandings; or*

*(c) for the maintenance of public order. (Emphasis added.)*

In slight contrast, the BIT between Japan and Viet Nam (2003) only carves out the article on compensation for losses from the scope of application of the security exception:

*Article 15*

*1. Notwithstanding any other provisions in this Agreement **other than the provisions of Article 10 [compensation]**, each Contracting Party may:*

*(a) take any measure which it considers necessary for the protection of its **essential security interests**... (Emphasis added.)*

The same result, although through a different technique, is achieved in some IIAs concluded by Belgium-Luxembourg. These agreements specify that security or national interests are a justification for expropriating or nationalizing a foreign investor. These security interests are therefore considered as being equivalent to a public purpose. Thereafter, the relevant IIA



provision confirms that security interests leave the obligation of the Contracting Party to pay adequate compensation unaffected. The BIT between Azerbaijan and Belgium-Luxembourg (2004) is an example:

*Article 4*

*Deprivation and limitation of ownership*

*1. Each Contracting Party undertakes not to adopt any measure of expropriation or nationalization or any other measure having the effect of directly or indirectly dispossessing the investors of the other Contracting Party of their investments in its territory.*

***2. If reasons of public purpose, security or national interest require a derogation from the provisions of paragraph 1, the following conditions shall be complied with:***

- a) the measures shall be taken under due process of law;*
  - b) the measures shall be neither discriminatory, nor contrary to any specific commitments;*
  - c) the measures shall be accompanied by provisions for the payment of an adequate and effective compensation.*
- (Emphasis added.)

Other BITs concluded by Belgium-Luxembourg include a definition of the term “public purpose”. According to this definition, the term “public purpose” encompasses “security or national interest”. An illustration is the BIT with Guatemala (2005):

*Article 1*

*Definitions*

*7. The term “public purpose” shall mean:*

- a) to the Kingdom of Belgium and the Grand Duchy of Luxembourg; public purpose, **security or national interest**,<sup>15</sup> (Emphasis added.)*

In a similar vein, the free trade agreement between Colombia and the United States (2006) explains in a footnote to article 10.7 that the term “public purpose” refers to a concept in customary international law, and that domestic law may express this or a similar concept using different terms, including “public necessity”.

### Notes

- 
- <sup>1</sup> Security-related exceptions appear consistently in the BITs concluded by Germany, India, Belgium-Luxembourg, Canada, the United States, and to a lesser degree Mexico. Sometimes, these exceptions appear under a different name, such as “essential security interests” or “public order”. All IIAs mentioned in this paper can be found at <http://www.unctad.org/ia>.
  - <sup>2</sup> See also the BITs concluded by India with Australia (1999), Croatia (2001), the Czech Republic (1996), Hungary (2003), Indonesia (1999), Kazakhstan (1996), Oman (1997), Sri Lanka (1997), Sweden (2000), Switzerland (1997), Thailand (2000), Turkey (1998), and the United Kingdom (1994).
  - <sup>3</sup> Also see the BIT concluded between the United States and Albania (1995), and the Business and Economic Relations Treaty concluded with Poland (1990).
  - <sup>4</sup> See also, for example, article 87 of the association agreement between the EU and Tunisia (1995) and article 22 of the free trade agreement between the EFTA States and Egypt (2007).
  - <sup>5</sup> For a similar approach, also see article 20 of the free trade agreement between Australia and Singapore (2003).
  - <sup>6</sup> See also, for example, article 87 of the association agreement between the EU and Tunisia (1995) and article 22 of the free trade agreement between the EFTA States and Egypt (2007).
  - <sup>7</sup> Available at: [http://untreaty.un.org/ilc/texts/instruments/english/conventions/1\\_1\\_1969.pdf](http://untreaty.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf)
  - <sup>8</sup> Ackerman, Rose, p.35 (2007).
  - <sup>9</sup> See also for a similar approach, the Multilateral Agreement on Investment negotiating text as of 24 April 1998.
  - <sup>10</sup> See also, for example, the BIT between India and Indonesia (1999).

- 
- 
- <sup>11</sup> See, for example, the BITs concluded by Germany with Barbados (1994), Antigua and Barbuda (1998), Botswana (2000), Mexico (1998), Nigeria (2000) and Sri Lanka (2000).
- <sup>12</sup> Another illustration is article 19 of the BIT between Austria and Mexico (1998).
- <sup>13</sup> Another example is the BIT between Jordan and Singapore (2004), articles 16 and 19.
- <sup>14</sup> See also the ECOWAS Energy Protocol (2003).
- <sup>15</sup> Also see the BITs concluded by Belgium-Luxembourg with Libya (2004) and Nicaragua (2005).



### III. INTERACTION WITH OTHER ISSUES AND CONCEPTS

As shown in the previous section, security-related exceptions can interact with concepts analysed in other papers of UNCTAD's series on issues in international investment agreements.<sup>1</sup> This section briefly discusses the interaction between these various principles. Table 1 shows the level of interaction of the national security exception with other key IIA provisions.

**Table 1. Interaction across issues and concepts**

Concepts in other papers	national security exceptions
Admission and establishment	++
Dispute settlement	+
Entry and sojourn of key personnel	+
Fair and equitable treatment	++
Most-favoured-nation treatment and national treatment	++
State contracts	++
Taking of property	++
Compensation for losses	++
Transfer of funds	++
Transfer of technology	+
Transparency	+

*Source:* UNCTAD.

Key: + = moderate interaction  
++ = extensive interaction

#### **Admission and establishment**

Most IIAs do not grant an unqualified right to foreign investors to make investments in the host country. These agreements provide that the parties shall admit investments of

investors of the other party in accordance with the laws and regulations of the host State. In this case, host States have the right to screen incoming investments and to accept or reject them in accordance with their national laws. This includes the right of Contracting Parties to refuse foreign investors for national security reasons. Thus, a separate security exception in the IIA to cover this situation would be redundant.

The situation is different with regard to the minority of IIAs that include a right of establishment. In this case the national security exception gains importance, because without it, the host country might be obliged to admit the foreign investment. This would be the case if the host country had not taken any sector-specific reservation concerning the investment activity for which entry is sought. The interaction between a right of establishment and the national security exception is therefore strong.

### **Compensation for losses**

Most IIAs contain a provision dealing with the compensation of foreign investors for losses due to war or civil strife. This clause is therefore closely related to the issue of national security, since war and similar events are the classic situation in which a country's national security is at stake. Also, a severe economic crisis could go along with internal upheavals and other turbulences. Nonetheless, it is difficult to imagine how a national security exception in an IIA could ever apply in respect of the provision on compensation for losses. Since the latter clause establishes obligations of the Contracting Parties expressly in a situation where the national security is at stake, it would be contradictory to dispense the parties from their fulfilment for national security reasons.

---

**Dispute settlement**

The relationship between a national security exception and investor–State dispute settlement depends considerably on the extent to which the former is self-judging. The more Contracting Parties reserve autonomy for themselves in deciding whether there is a threat to national security and how to respond to it, the less room remains for a judicial review of security-related measures.

Another possible interaction relates to the transparency in arbitral proceedings. Some IIAs limit transparency in arbitral proceedings if the disclosure of information could constitute a threat to the national security of a Contracting Party.

**Entry and sojourn of key personnel**

Provisions on the entry and sojourn of foreign key personnel related to the issuing of visas and work permits are aimed at facilitating the operation of investments in the host country. The vast majority of IIAs makes both the admission and the personnel concerned subject to the legislation of the host country. Host countries therefore have the right to reject such personnel for national security reasons. An additional security exception in the IIA is therefore not strictly necessary.

**Fair and equitable treatment**

Fair and equitable treatment has at least two possible meanings. Firstly, it could be given its plain meaning – that beneficiaries are entitled to fairness and equity, as these terms are understood in non-technical language. Secondly, it could imply that beneficiaries are assured treatment in keeping with the international minimum standard for investors. In the case of a national security crisis, Contracting Parties might not always be able to respect either of these standards. This could especially be the case in times of severe economic crisis that require emergency

measures to be taken. By contrast, if the host country raises national security concerns in less dramatic circumstances, for instance in connection with protecting its strategic industries, it would be more difficult to justify a denial of fair and equitable treatment.

### **National treatment and most-favoured-nation treatment**

The extent to which the principles of national treatment and most-favoured-nation treatment may become relevant under national security considerations largely depends on whether these standards apply to the entry of an investor or to the post-establishment phase. As explained in section I.B.2, there is little interaction with a security exception if the IIA only contains an admission clause to the effect that the host country retains full discretion whether to permit the establishment of foreign investors or not. By contrast, the interaction may be strong in cases where the IIA includes a right of establishment.

As far as post-establishment treatment is concerned, national security concerns may prevent a Contracting Party from according foreign investors non-discriminatory treatment. This is most obvious if it considers that a particular foreign country poses a security problem. In that case, the host country might wish to restrict the investment activities of investors from that country, and thus contradict its obligations as regards national treatment and most-favoured-nation treatment. For example, it may wish to establish special reporting requirements for such investments, or subject them to other control mechanisms that it considers appropriate. Once again, a national security exception would assure host countries that they may take such action without necessarily violating the IIA.

At the same time, one of the most common conditions in IIAs for invoking the exception is that the measure must not be arbitrary or constitute an unjustifiable discrimination. Under those



IAs, the non-discrimination standard is therefore not completely abolished.

### **State contracts**

Foreign investment projects may be governed by individual investment contracts (state contracts) between the foreign investor and the host country. Numerous IAs include a provision requiring the Contracting Parties to respect any obligation that they have assumed with regard to investments of investors from the other party. Such other obligations may, in particular, be included in state contracts. In cases of national security concerns, a host country may see a need to change the terms of the contract, or to cancel it altogether. For example, a new government may adopt a policy under which it declares that an economic sector that was open to foreign investors in the past is strategically important and security-sensitive and is therefore reserved for domestic companies. If the foreign investor has been operating on the basis of an investment contract, this could imply its annulment by the government. Likewise, in the case of a severe economic crisis, the host country might not longer be able to respect all of its obligations, for instance in respect of foreign exchange regulations. A national security exception in the IIA that is broad enough to cover these scenarios may give the state the right to do this without violating the agreement. Otherwise, the principle of *pacta sunt servanda* would apply, and the host country could seek a termination or renegotiation of the contract only in the case of a fundamental change of circumstances (*clausula rebus sic stantibus*).

### **Taking of property**

The example above also illustrates what role a national security exception might play in connection with the expropriation article in IAs. A forced disinvestment for national security reasons – or any other substantial interference affecting the core of the

foreign investor's property rights – would amount to an expropriation of the investor, with the result that the host country would have to pay compensation. A national security exception could exempt the host country from this obligation.

However, as shown in section II.D, a number of IIAs carve out the expropriation provision from the scope of the security exception. In this case, the host country continues to be obliged to pay compensation to the foreign investor even if the property was taken for national security reasons.

### **Transfer of funds**

The transfer provision included in most IIAs allows foreign investors to freely make payments and other capital movements relating to their investment. This provision ensures that a foreign investor will be able to enjoy the economic benefits of a successful investment. However, in times of crisis, a sudden massive repatriation of capital by foreign investors may result in severe depletion of foreign exchange reserves in host countries, particularly developing countries. This, in turn, may create important balance of payments difficulties. Numerous IIAs therefore include a balance of payments clause, allowing Contracting Parties to temporarily restrict the transfer of funds in such a situation.

In the absence of a balance of payments clause in the IIA, a Contracting Party may wish to have recourse to a national security exception in order to be able to restrict transfers without violating the IIA. A severe economic crisis may constitute a state of emergency in which the security clause applies.

### **Transfer of technology**

Few IIAs include a provision on the transfer of technology, under which Contracting Parties undertake to promote such

transfers. However, if the Contracting Parties deem the technology in question to be “sensitive”, they may wish to restrict such transfers.

Concerns in relation to the transfer of “sensitive” technology can be analysed from two different perspectives. From the perspective of home countries, the sharing of technology might not be desired if such technology could be used for military purposes, for instance. Dual-use technology, which can be used both for peaceful and military objectives, may be particularly sensitive. Examples include technology used for the production of pesticide, night-vision technology, and powerful computer technology that could be used for intelligence gathering or cybercrime. From the perspective of host countries, concerns relate to technologies brought in by foreign investors that could be used, among other things, for industrial or military espionage. With a national security exception in place, IIA Contracting Parties may be able to impede both inbound and outbound transfers of technology without infringing upon the transfer promotion article in the agreement.

### **Transparency**

IAs sometimes include a provision aimed at promoting transparency and exchange of information on investment laws and regulations and other investment-related matters between the Contracting Parties. Some agreements include an exception to this obligation, if the furnishing of such information is considered to be contrary to the Contracting Parties’ “national security” interests.

**Note**

- 
- <sup>1</sup> UNCTAD's series on issues in international investment agreements is available at <http://www.unctad.org/iaa>.

## **IV. POLICY OPTIONS IN RESPECT OF THE PROTECTION OF NATIONAL SECURITY IN IIAS**

This section explores what possibilities IIA negotiators have at hand to deal with national security considerations in respect of foreign investment. The fundamental questions here are whether the IIA should include a national security exception at all, and if so, whether such a clause should be self-judging or not. The answer depends, in principle, on how IIA Contracting Parties weigh their national security interest against the goal of investment protection. The greater they consider the need to defend national security concerns in connection with foreign investment in the IIA, the less inclination they will have to refrain from a national security exception in the agreement or to fully delegate the power to assess the legality of security-based investment restrictions to arbitration tribunals. If, by contrast, investment protection is the primary goal, then countries may be more open to the option of not including a national security exception in the agreement, or – if they agree upon such a provision – of allowing a stronger judicial review of whether there was indeed a threat to national security, and whether the measures taken were actually necessary to counter that threat.

### **A. No exception related to national security**

A first option would be not to include any security-related exception in the IIA. Indeed, many existing investment treaties do not contain such a provision. Although countries following this approach would be conscious of security issues in connection with foreign investment, they would be of the opinion that national security concerns – should they ever arise – could be addressed without contradicting the obligations in the IIAs that they have concluded. Thus, a decision not to include a national-security-

related exception does not mean that Contracting Parties would be impeded from taking measures against foreign investors based on national security concerns. They could do so as long as such measures were not at variance with their IIA obligations. For instance, if the IIA included the principle of non-discrimination and the standard of fair and equitable treatment, then security-related measures that were taken in a non-discriminatory manner and that were fair and equitable would be permitted. Also, security-related restrictions would have to respect IIA obligations relating to expropriation, the freedom of capital transfers and the umbrella clause.

This approach would therefore give the message to foreign investors that even if security concerns arose with regard to their investments, they would not become lawless under the IIA. They would continue to be treated in a non-discriminatory manner; if an expropriation became necessary they could still claim adequate compensation. The borderline would only be reached if the foreign investor had breached the host country's security-related legislation so that the investment activity became illegal. In that case, the IIA would not prevent the host country from taking sanctions against the foreign investor.

Whether to keep any kind of national security exception out of the IIA may also depend on the scope of the treaty. In rare cases where an IIA contains pre-establishment commitments only, one could argue that IIA Contracting Parties have alternative means at hand to accommodate security-related concerns. As shown in section I.B.2, they could carve out security-sensitive sectors and strategic industries from the scope of the right of establishment. This would be a less intrusive approach than a full-blown exception clause, and would also provide more legal clarity and security. Still, one could ask whether Contracting Parties would feel comfortable with such a closed list of restrictive sectors, or whether they would prefer to maintain more discretion through an open-ended security exception.

In the most common case of IIAs covering the post-establishment phase, Contracting Parties might feel a stronger need for a national security clause, since otherwise they could only refer to customary international law to excuse a violation of their treaty obligations for national security reasons. However, as has been explained in section I.B.3, the defence under customary international law has a narrower scope than a treaty-based national security exception, and Contracting Parties might therefore not consider it as a full substitute for the latter. In particular, if a Contracting Party wants to protect its strategic industries, it is doubtful that it could do so under customary international law. In the case of economic crisis, too, customary international law would set a high threshold for successful invocation of the clause. Even if Contracting Parties are not convinced that a national security exception is indeed required, they may wish to include it for psychological reasons, because it makes them feel more comfortable.

The state of the relationship between the Contracting Parties may also play a role, to a certain extent. If the Contracting Parties share a history of peaceful and friendly relations, they may be more ready to conclude an IIA without a national security exception than in a case where tensions existed. On the other hand, as the example of the EU shows, even member countries of a very close and advanced regional integration organization still see a need for national security exceptions. Furthermore, while friendly relations between the Contracting Parties may exclude defence-related concerns, the existence of such relations may be much less relevant in connection with attempts to protect strategic industries or to tackle an economic crisis.

#### **B. Clarification of the term “essential security interests”**

In order to provide more clarity and predictability concerning the applicability of the national security exception,

Contracting Parties could consider defining the term more precisely in the IIA. A range of options exists, as outlined in chapter II. The principal choices relate to the concrete expression used, and the precision with which it is circumscribed.

As shown in chapter II, the term “essential security interests” is not the only one that could be used in this context. Other options include “international peace and security”, “public order”, or “extreme emergency”. Further alternatives are “public health” or “public morality”.

The crucial question is whether any of these terms is more concrete than others and could therefore help to clarify its scope and meaning. Obviously, this is the case with a number of expressions, while with regard to others it would be more intricate to make such a distinction. Without denying the difficulties in trying to draw a borderline, it seems possible to distinguish between the following two broad categories (table 2):

**Table 2. Options for security-related IIA exceptions**

Narrow options	Broad options
<ul style="list-style-type: none"> <li>• International peace and security</li> <li>• Public health</li> <li>• Public morality</li> <li>• Extreme emergency</li> </ul>	<ul style="list-style-type: none"> <li>• National security</li> <li>• Public order</li> <li>• Essential security interests</li> </ul>

*Source:* UNCTAD.

The suggested distinction between narrow and broad options does not mean, however, that with regard to the former category definition problems would disappear. Even the narrow options are still sufficiently broad as to allow for different interpretations. The difference – in comparison with the “broad” options – is that this scope of interpretation is smaller. In



particular, considerable common ground exists concerning the interpretation of the terms “international peace and security” and “public health”. By contrast, the term “public morality” might be subject to rather divergent understandings in different societies and cultures.

An important consequence of the “narrow” approach is that it excludes certain kinds of protective measures from its scope of application. In particular, the protection of strategic industries could not be justified under this method, apart from some kinds of critical infrastructure, namely water and sanitation, which may be covered by a “public health” exception. As far as economic crisis is concerned, it may fall under the category of “extreme emergency” if it reaches a very serious level.

While the selection of a more precise term could be a first step in rendering the content and scope of the security exception more precise, Contracting Parties could still go further by adding an interpretative statement concerning its meaning. For example, several IIAs clarify that measures to promote international peace and security may (only) relate to the production or supply of arms and ammunition, the supply of services for the purpose of provisioning a military establishment, or the non-proliferation of weapons. Similar explanation could be provided with regard to other terms, such as “public health” or “extreme emergency”.

As regards the broad options, some scaling according to their level of vagueness also seems possible. One crucial issue for clarification could be the distinction between a “public order exception” and a “national security exception”, often also referred to as an “essential security interest exception”. Do these two concepts overlap, or do they refer to different situations? It has been suggested that “public order” would cover measures to ensure public health and safety, whereas the national security exception would relate to security-related actions taken in time of war or national emergency.<sup>1</sup> GATS explicitly distinguishes between a

public order exception and one on national security. Others may understand the concept of public order more broadly, to also encompass measures taken to defend essential security interests vis-à-vis a foreign state. Some IIAs have clarified that the public order exception may only be invoked where there is a genuine and sufficiently serious threat to one of the fundamental interests of society (see section II.A.2).

Whichever expression the Contracting Parties choose, they have to decide whether they wish to clarify the applicability of the exception in case of economic crisis and the protection of strategic industries. Otherwise, neither the host country nor the foreign investor could be sure whether the clause could be successfully invoked in any of those situations. This is particularly relevant for the protection of strategic industries since – apart from the EU – there is hardly any international case law available from which one can take any guidance. Clarifying the term “essential security interests” and related expressions could be an attractive option for countries concerned that a broad and vague formulation of the clause comes at the expense of providing adequate investment protection.

Contracting parties following this approach could agree on the applicability or inapplicability of the security exception with regard to economic crisis and the protection of strategic industries. Also, some intermediary solutions could be envisaged. For instance, the Contracting Parties could come to an understanding that only economic crisis reaching a certain level would be covered under the security exception. Likewise, to the extent that there is agreement to cover strategic industries under the security exception, Contracting Parties might wish to draw up a list of sectors or activities that they consider as strategically important in order to further improve legal clarity and predictability. While this approach would leave Contracting Parties with full regulatory discretion concerning the adoption and maintenance of entry restrictions in these sectors, it would exclude them from applying

---

such measures with regard to sectors not covered by this provision. The remaining freedom of Contracting Parties could be further enhanced in respect of the discretion concerning the question of how to respond to the threat (see section C below).

### C. Necessity of the host country response

Another crucial matter for IIA negotiators is the extent to which Contracting Parties should be free to decide *how* to respond to a security threat. That is to say, whereas so far the issue has been what degree of discretion to accord to Contracting Parties as regards assessment of whether there is a threat to its national security, the query is now about the appropriate autonomy in the follow-up actions.<sup>2</sup>

The alternatives for Contracting Parties are to agree upon a self-judging clause, or to allow for a judicial review of whether the host country measure was objectively necessary in order to respond to the threat. In the former case, they would agree upon a text according to which Contracting Parties may take any measure which *they consider* necessary. In the latter case, only such measures would be permitted that *are* necessary from a neutral point of view.

#### 1. Self-judging clause

A self-judging exception would be a strong means of protecting a host country's national security interests. Once it has been determined that the threat in question falls under the security exception as such, the host country would be free to choose the response that it finds adequate. Such an approach would recognize that it is the sovereign right of a country to determine, on its own, how serious the threat to its security interests is, and what needs to be done to address it. For instance, in the case of a serious economic crisis, it could decide to impose transfer restrictions, change the exchange rate, or withdraw from its obligations under

an investment contract. With regard to its strategic industries having importance for its national security, the host country may determine to prohibit foreign takeovers altogether, or to impose restrictions on the operations of foreign investors. The foreign investor could not challenge the legality of any of these responses by arguing that the host country would have had less severe means available to protect its security interests. There would be no room for such a proportionality test.

On the other hand, a self-judging exception clause may be at odds with the goal of investment protection. The more discretion it grants to the host country, and the fewer safeguards it contains for the foreign investor, the less the IIA can fulfil its function of providing legal clarity, stability and predictability. A very broad national security exception may therefore severely diminish the investment promotion function of IIAs, and may risk distorting the delicate balance between the protection of public and private interests in IIAs. Therefore, Contracting Parties concerned about this risk may wish to introduce other guarantees into the IIA that strengthen investor confidence (see section D below.)

One could ask whether a self-judging clause would be more justified in cases of military conflict or in other emergency situations such as a severe economic crisis, than with regard to the protection of strategic industries, where government measures usually have a preventive character rather than addressing an actual calamity. Accordingly, the point could be made that in such less dramatic situations, a country should find it easier to accept that a third party has the right to review the necessity of the measure. The counter-argument would be that if the protection of strategic industries has been recognized as being relevant to security, then a country should be as free to choose its response as in the case of a military threat or other emergency.

## 2. Non-self-judging clause

Alternatively, IIA Contracting Parties could agree to the necessity of the host country response to a security threat being subject to judicial review. Accordingly, recourse to the national security exception would only be permitted if the host country could prove that the measure taken contributed to the realization of the legitimate aim of protecting its essential security interests, and that it did not have reasonably available alternatives, less in conflict or more compliant with its international obligations.<sup>3</sup> This approach would therefore include a proportionality test, under which a tribunal could examine whether the degree of the investment restriction corresponds to the seriousness of the threat to the country's national security.<sup>4</sup>

For example, if the host country prohibits foreign investment in its strategically important sectors, a non-self-judging exception clause would give the arbitration tribunal the right to determine whether the less severe means of control over the activities of established investors would be sufficient to protect the country's security interests. If the tribunal comes to this conclusion, it could declare that the ban on foreign investment is excessive and is not covered by the security exception of the IIA. In the case of an economic crisis, the tribunal could, for instance, check whether, at the time that the measure was adopted, the crisis was already evolving towards normality, with the consequence that the action was no longer necessary.<sup>5</sup>

It goes without saying that a non-self-judging exception clause would limit the Contracting Parties' sovereign right to protect their national security considerably. It would give arbitral tribunals in such a critical area as national security the right and duty to decree what a country is and is not allowed to do. To some extent, IIA Contracting Parties would be putting their destiny into the hands of arbitrators. The tribunal would make a final and binding judgment as to whether or not the measures of the host

country were actually necessary to protect its national security. While the tribunal's power would not go so far as to pass a judgment on the wisdom of a country's economic policy in general, it would nevertheless be entitled to assess the legality and reasonableness of government measures in such crucial areas as the tackling of an economic crisis and the conduct of strategic economic policies. From a host country's point of view, agreeing to a non-self-judging exception clause may therefore well be perceived as putting itself into a legal straightjacket with the potential result of being unable to respond to a perceived security threat in the desired way.

In light of these concerns, how can it be explained that a critical number of IIAs nevertheless include a non-self-judging security-related exception clause? What possible reasons could Contracting Parties have to agree to a judicial control of their sovereign right to adopt measures of their choice to respond to a security threat? Firstly, a non-self-judging clause enhances investment protection. Foreign investors will feel more reassured about the investment climate in the host country if the necessity of the latter's response to a security threat can be subject to judicial review. This may be particularly important in the context of measures that reach beyond the military realm and affect the broader area of economic and competitive policies. Secondly, the choice between a self-judging and a non-self-judging exception clause may be the result of the different interests and bargaining powers of the IIA Contracting Parties. If the IIA is concluded between a strong capital-exporting country and a relatively weak capital-importing developing country, the likelihood is high that the former will insist on a non-self-judging clause, because this ensures better protection for its investors abroad. The same could happen in a South-South context if investments between the two countries were mainly flowing only in one direction.

Finally, it should be remembered that the distinction between self-judging and non-self-judging exceptions is more

subtle than it may appear at first sight. Even if a national security clause falls into the first category, it is still subject to a “good faith” test under international law (see section I.B.3). On the other hand, a non-self-judging provision would neither give arbitration tribunals the authority to completely ignore the assessment of the state invoking the exception, nor to dictate which concrete measure to take in the case that several comparable policy options were available.

#### **D. Additional means of limiting the scope of application of a security-related exception**

Several more possibilities exist for countries wishing to further clarify and narrow the scope of application of the national security exception.

##### **1. Introducing a “good faith” requirement**

One method would be to expressly condition the right of invoking the security exception to the requirement that Contracting Parties act in good faith. Accordingly, Contracting Parties would confirm an international law principle that can also be found in the Vienna Convention on the Law of Treaties.

As has been shown in sections II.B.1 and II.B.2, a number of IIAs provide that the use of the exception must not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on trade. Thus, in the case of a dispute about the legality of an investment restriction based on essential security interests, the good faith requirement would be subject to judicial review. This “safeguard” could, in particular, play a role in relation to a host country’s attempts to protect its strategic industries or to react to an economic crisis. Arbitration tribunals would have the right to examine whether the protection efforts are indeed rooted

in national security concerns or whether they have a primarily protectionist background.

## **2. National security exception only in respect of certain IIA provisions**

Another approach would be to give Contracting Parties the right to invoke the national security exception only in respect of certain IIA provisions. For instance, as has been shown in chapter II, a number of IIAs provide that the use of the exception clause is limited to the right of establishment. Accordingly, IIA Contracting Parties could invoke the exception only with regard the entry of foreign investors, but not in respect of the treatment of established investors. Another example concerns the freedom of capital transfers, or the non-discrimination clause.

Some IIAs grant Contracting Parties only the right to restrict transparency in the case of a security threat. Thus, foreign investors could be denied access to certain information, the publication of which would create a risk for the host country's national security. There is also the option of dealing with national security issues particularly in the context of investor–State dispute settlement. As has been shown in section II.C.1, a number of IIAs provide for the possibility of limiting public participation in such proceedings, if there would otherwise be a risk for national security.

This technique of limiting the applicability of the security exception might be especially appealing to countries that do not want to abandon a security exception completely, but seek to limit its use to a minimum. Seen from the angle of investment protection, this approach has the advantage of respecting investor rights as much as possible. On the other hand, embarking on this road may be a demanding task for Contracting Parties, since they have to examine carefully in which areas a security exception is needed.



---

Particularly when it comes to economic crisis, this method might not be feasible, because the country concerned might need a dispensation from several core obligations of an IIA, such as transfer guarantees, the umbrella clause, or compensation payments in the case of an expropriation.

### **3. Non-applicability of the national security exception in respect of certain IIA provisions**

Contracting parties could also follow the opposite strategy and identify those IIA provisions in respect of which they would *not* allow the use of the national security exception. An example is the Energy Charter Treaty, which expressly excludes the expropriation article and the one on compensation for losses from the scope of application of the exception. Thus, while Contracting Parties would, in principle, be allowed to take security-related investment measures, foreign investors would at the same time be assured of some basic guarantees that host countries have to respect under any circumstances.

As in option 2 above, this approach would seek a balance between the security interests of the Contracting Parties and the protection needs of the foreign investor. The difference between the two methods is that in the first alternative (option 2 above) more weight is given to the goal of investment protection, whereas in the second alternative the emphasis is more on security concerns.

The method of excluding the applicability of the security exception with regard to certain IIA provisions could become particularly relevant in connection with the protection of strategic industries. Host countries that have decided that certain strategic industries should be under national control might nevertheless want to reassure foreign investors that they will be properly compensated in case they have to give up their investment. Under a broad and open-ended security exception, such a constraint would

not exist – a short-term advantage for the host country for which it may have to pay dearly, since it reduces the host country's attractiveness as a foreign investment destination. Conversely, when it comes to economic crisis, Contracting Parties might find it more difficult to guarantee that the security exception will not apply in respect of core IIA provisions.

#### **4. Periodic review of the measure**

A further option could be that IIA Contracting Parties provide for a periodic review and consultations concerning the need to maintain security-related investment restrictions. For instance, if a Contracting Party has closed a specific sector to foreign investors – or maybe only to investors of the other Contracting Party – both could agree that they discuss the necessity of this restriction from time to time. Similarly, in the case of an economic crisis, Contracting Parties could consent to regularly assess whether the crisis is still strong enough to justify investment restrictions. Thus, Contracting Parties would not give up their sovereign right to decide whether the restriction is necessary or not, but they would at least allow this issue to be examined on a regular basis.

---

### Notes

- 
- <sup>1</sup> This is, for instance, the understanding of the United States. See White/von Staden, *Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties*, in: *Virginia Journal of International Law*, Winter 2008.
  - <sup>2</sup> While in theory it is possible to draw this distinction, it is more difficult to separate both aspects in practice.
  - <sup>3</sup> *Continental Casualty Company v The Argentine Republic*, ICSID case no. ARB/03/9A, award of 5 September 2008, para. 196-198.
  - <sup>4</sup> Note that concerns have been expressed about the extent to which international economic tribunals would be suited to applying a proportionality test that involves weighting and balancing between economic and non-economic values. See Neumann and Tuerk, 2003.
  - <sup>5</sup> *Continental Casualty Company v The Argentine Republic*, ICSID case no. ARB/03/9A, award of 5 September 2008, para. 221-222.



## CONCLUSION

After almost two decades of a global move towards investment liberalization, an increasing number of countries have reviewed the results of these policies and taken adjustment measures. Three developments are responsible for this change: In some cases, governments have been disappointed with the results of their privatization policies and with investment contracts considered to be too favourable to foreign investors. In other instances, states have seen a need to reassert national control over natural resources, other strategically important industries, and critical infrastructure. In addition, the rapid expansion of sovereign wealth funds and state-owned enterprises has led to demands in several industrialized countries to exercise tighter control over the investment activities of the former. Finally, the current global economic crisis has triggered renewed protectionist tendencies in the investment area.

Often, these newly emerging policy concerns vis-à-vis foreign investment have their roots in national security considerations. In the foreign investment context, national security is no longer only perceived as the absence of military threats, but is understood in a much wider sense where domestic industries considered as vital to a country's competitiveness and future need to be protected against foreign takeovers. While in some cases it appears that these policies are still in an experimental phase, are conducted on a case-by-case basis, and have not yet resulted in a clear strategy, there is a tendency towards more caution in the admission of foreign investors, and an increasing mingling of political and economic considerations.

Another area where national security interests have gained ground has to do with economic crisis. Several investment disputes in recent years had their origin in emergency measures that host countries imposed on foreign investors in order to fight economic

crises. In each case, the country argued that these measures were needed to protect its internal security.

These developments have important implications for international investment rulemaking. Host countries have to ask themselves to what extent they are still free to impose restrictions based on national security considerations once they have concluded an IIA. From the perspective of the foreign investor, the degree to which IIAs protect them against such measures becomes crucial.

Many IIAs include an exception clause allowing Contracting Parties to deviate from their IIA obligations in the case of a threat to their essential security interests. In most cases, these clauses are drafted in a general manner that leaves Contracting Parties ample discretion to decide whether a particular investment poses a threat to national security and how to respond to the threat. While there are good reasons for such an approach in questions of war and peace, it is a more doubtful approach in situations where it cannot be ruled out that investment restrictions are not only based on security considerations but are also influenced by non-security-related concerns such as protectionist tendencies.

The recent debate about security concerns in relation to foreign investment has special relevance for investors from developing countries and emerging economies. Developing countries in particular may face the risk of economic crisis, with the result that they see themselves compelled to impose temporary investment restrictions to improve the situation. Emerging economies and their SWFs are especially exposed to the risk of investment restrictions aimed at protecting the strategic industries of host countries.

The impact of these developments on IIA rulemaking is twofold. Firstly, IIA negotiators have to consider whether the IIA should contain a “national security exception” and whether in their view this clause is meant to apply to emergency measures in case of economic crisis and to policies aimed at protecting strategic industries. Secondly, they may wish to clarify the conditions under which Contracting Parties may invoke the exception.

For developing countries, choosing the “right” option might not be easy. Those facing the risk of severe economic crisis may wish to have a security exception in the IIA covering this scenario. However, while protecting their sovereign right to respond to economic crisis as they see fit, they must also be careful that this freedom does not result in a considerable reduction in the level of investment protection. Emerging economies, on the other hand, must have an interest that security-related exception clauses in IIAs do not substantially deprive their investors abroad of the protection afforded by these treaties. Thus, they may wish security-related exceptions to be drafted relatively narrowly and to be subject to judicial review. These divergent objectives may create a certain dilemma for those developing countries that are both home and host countries of foreign investment.

Overall, addressing national security concerns in IIAs nowadays has to be seen in the broader context of host countries’ policies aimed at strengthening their economies and enhancing their international competitiveness. Each country needs to decide for itself whether it considers a security-related exception as important for this purpose. Whatever policy a country adopts, it is important that the goal of preserving the sovereign right of each country to adopt any kind of measures it considers appropriate to respond to economic crisis and to protect its strategic industries does not come at the price of having a discouraging effect on foreign investors and undermining the attractiveness of the country as a foreign investment location. Uncertainty about the scope of the security-related exception and the modalities of its

application could significantly undermine investor confidence. Therefore, striking a reasonable balance between the legitimate security concerns of host countries on the one hand and a sufficient degree of investment protection on the other hand is key to sustaining the ultimate goal of IIAs, namely to make investment work for development.



## REFERENCES

- Bottini G (2008). Protection of essential interests in the BIT era. In: Grierson Weiler TJ ed. *Investment Treaty Arbitration and International Law*. New York. JurisNet: 145–164.
- Burke-White W and von Staden A (2007). Investment protection in extraordinary times: the interpretation and application of non-precluded measures, provisions in bilateral investment treaties. *Scholarship at Penn Law*. University of Pennsylvania Law School. Paper No. 152, November 2007. Available at <http://lsr.nellco.org/upenn/wps/papers/152>
- Casarini N (2007). China flexes global investment muscles. International Relations and Security Network (ISN). *ISN Security Watch*. 16 October 2007. Available at: <http://www.isn.ethz.ch/isn/Current-Affairs/Security-Watch/Detail/?ots591=4888CAA0-B3DB-1461-98B9-E20E7B9C13D4&lng=en&id=53796>
- Hoegge B (2007). Credit crisis puts focus on sovereign wealth funds. *Bangkok Post*. Thailand. 20 December 2007. Available at: [http://archives.mybangkokpost.com/bkkarchives/frontstore/news\\_detail.html?aid=218833&textcat=Business%20News&type=t&key=credit%20crisis&year=2007&click\\_page=1&search\\_cat=text&from=text\\_search](http://archives.mybangkokpost.com/bkkarchives/frontstore/news_detail.html?aid=218833&textcat=Business%20News&type=t&key=credit%20crisis&year=2007&click_page=1&search_cat=text&from=text_search)
- Neumann J and Tuerk E (2003). Necessity revisited: proportionality in World Trade Organization law after Korea beef, EC asbestos and EC sardines. *Journal of World Trade*. Vol. 37, No. 1.
- Rose-Ackerman S and Billa B (2007). Treaties and national security. Yale Law and Economics research paper no. 351. Available from the Social Science Research Network Paper Collection at: <http://ssrn.com/abstract=1001460>

- Sauvant K (2006). Is foreign direct investment still a welcome tool? *Taipei Times*. 7 September 2006. Taiwan (Province of China). Available at:  
<http://www.taipeitimes.com/News/editorials/archives/2006/09/07/2003326593>
- Singh K (2007). *Why Investment Matters: The Political Economy of International Investments*. London and Delhi: FERN, The Corner House, Madhyam Books. Also available at:  
[http://www.fern.org/media/documents/document\\_3891\\_3921.pdf](http://www.fern.org/media/documents/document_3891_3921.pdf)
- Truman, EM (2007). Sovereign wealth funds: the need for greater transparency and accountability. Policy Briefs, No. PB07-6. Washington, D.C. Peterson Institute for International Economics.
- UNCTAD (2008). *World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge*. United Nations publication. Sales No. E.08.II.D.23. New York and Geneva.
- UNCTAD (2007a). *World Investment Report 2007: Transnational Corporations, Extractive Industries and Development*. United Nations publication. Sales No. E.07.II.D.9. New York and Geneva.
- UNCTAD (2007b). *Investor–State Dispute Settlement and Impact on Investment Rulemaking*. United Nations publication. Sales No. E.07.II.D.10. New York and Geneva.
- UNCTAD (2006). *World Investment Report 2006: FDI from Developing and Transition Economies: Implications for Development*. United Nations publication. Sales No. E.06.II.D.11. New York and Geneva.

---

Wharton School of the University of Pennsylvania (2007). A closer look at sovereign wealth funds: secretive, powerful, unregulated and huge. Knowledge@Wharton. 12 December 2007. Available at: <http://knowledge.wharton.upenn.edu/article.cfm?articleid=1868>



# SELECTED UNCTAD PUBLICATIONS ON TRANSNATIONAL CORPORATIONS AND FOREIGN DIRECT INVESTMENT

(For more information, please visit [www.unctad.org/en/pub](http://www.unctad.org/en/pub))

## A. SERIAL PUBLICATIONS

### *World Investment Reports*

(For more information visit [www.unctad.org/wir](http://www.unctad.org/wir))

*World Investment Report 2008. Transnational Corporations and the Infrastructure Challenge.* Sales No. E.08.II.D.23. \$80.  
[http://www.unctad.org/en/docs/wir2008\\_en.pdf](http://www.unctad.org/en/docs/wir2008_en.pdf).

*World Investment Report 2008. Transnational Corporations and the Infrastructure Challenge. An Overview.* 42 p. [http://www.unctad.org/en/docs/wir2008overview\\_en.pdf](http://www.unctad.org/en/docs/wir2008overview_en.pdf).

*World Investment Report 2007. Transnational Corporations, Extractive Industries and Development.* Sales No. E.07.II.D.9. \$75. [http://www.unctad.org/en/docs/wir2007\\_en.pdf](http://www.unctad.org/en/docs/wir2007_en.pdf).

*World Investment Report 2007. Transnational Corporations, Extractive Industries and Development. An Overview.* 50 p. [http://www.unctad.org/en/docs/wir2007overview\\_en.pdf](http://www.unctad.org/en/docs/wir2007overview_en.pdf).

*World Investment Report 2006. FDI from Developing and Transition Economies: Implications for Development.* Sales No. E.06.II.D.11. \$75.  
[http://www.unctad.org/en/docs/wir2006\\_en.pdf](http://www.unctad.org/en/docs/wir2006_en.pdf).

*World Investment Report 2006. FDI from Developing and Transition Economies: Implications for Development. An Overview.* 50 p.  
[http://www.unctad.org/en/docs/wir2006overview\\_en.pdf](http://www.unctad.org/en/docs/wir2006overview_en.pdf).

*World Investment Report 2005. Transnational Corporations and the Internationalization of R&D.* Sales No. E.05.II.D.10. \$75.  
[http://www.unctad.org/en/docs/wir2005\\_en.pdf](http://www.unctad.org/en/docs/wir2005_en.pdf).

*World Investment Report 2005. Transnational Corporations and the Internationalization of R&D. An Overview.* 50 p. [http://www.unctad.org/en/docs/wir2005overview\\_en.pdf](http://www.unctad.org/en/docs/wir2005overview_en.pdf).

*World Investment Report 2004. The Shift Towards Services.* Sales No. E.04.II.D.36. \$75. [http://www.unctad.org/en/docs/wir2004\\_en.pdf](http://www.unctad.org/en/docs/wir2004_en.pdf).

*World Investment Report 2004. The Shift Towards Services. An Overview.* 62 p. [http://www.unctad.org/en/docs/wir2004overview\\_en.pdf](http://www.unctad.org/en/docs/wir2004overview_en.pdf).

*World Investment Report 2003. FDI Policies for Development: National and International Perspectives.* Sales No. E.03.II.D.8. \$49. [http://www.unctad.org/en/docs/wir2003\\_en.pdf](http://www.unctad.org/en/docs/wir2003_en.pdf).

*World Investment Report 2003. FDI Policies for Development: National and International Perspectives. An Overview.* 66 p. [http://www.unctad.org/en/docs/wir2003overview\\_en.pdf](http://www.unctad.org/en/docs/wir2003overview_en.pdf).

*World Investment Report 2002: Transnational Corporations and Export Competitiveness.* 352 p. Sales No. E.02.II.D.4. \$49. [http://www.unctad.org/en/docs/wir2002\\_en.pdf](http://www.unctad.org/en/docs/wir2002_en.pdf).

*World Investment Report 2002: Transnational Corporations and Export Competitiveness. An Overview.* 66 p. [http://www.unctad.org/en/docs/wir2002overview\\_en.pdf](http://www.unctad.org/en/docs/wir2002overview_en.pdf).

*World Investment Report 2001: Promoting Linkages.* 356 p. Sales No. E.01.II.D.12 \$49. <http://www.unctad.org/wir/contents/wir01content.en.htm>.

*World Investment Report 2001: Promoting Linkages. An Overview.* 67 p. <http://www.unctad.org/wir/contents/wir01content.en.htm>.

*Ten Years of World Investment Reports: The Challenges Ahead. Proceedings of an UNCTAD special event on future challenges in the area of FDI.* UNCTAD/ITE/Misc.45. <http://www.unctad.org/wir>.

*World Investment Report 2000: Cross-border Mergers and Acquisitions and Development.* 368 p. Sales No. E.99.II.D.20. \$49. <http://www.unctad.org/wir/contents/wir00content.en.htm>.

*World Investment Report 2000: Cross-border Mergers and Acquisitions and Development. An Overview.* 75 p. <http://www.unctad.org/wir/contents/wir00content.en.htm>.

***World Investment Directories***

(For more information visit

[http://ro.unctad.org/en/subsites/dite/fdistats\\_files/WID2.htm](http://ro.unctad.org/en/subsites/dite/fdistats_files/WID2.htm))***World Investment Directory 2004: Latin America and the Caribbean. Volume IX.*** 599 p. Sales No. E.03.II.D.12. \$25.***World Investment Directory 2003: Central and Eastern Europe. Vol. VIII.*** 397 p. Sales No. E.03.II.D.24. \$80.***Investment Policy Reviews***(For more information visit <http://www.unctad.org/pr>)***Investment Policy Review – Rwanda.*** 130 p. Sales No. E.06.II.D.15. \$25***Investment Policy Review – Colombia*** 73 p. Sales No. E06.II.D.4 \$25***Investment Policy Review – Kenya.*** 126 p. Sales No. E.05.II.D.21. \$25.***Investment Policy Review – Benin.*** 147 p. Sales No. F.04.II.D.43. \$25.***Investment Policy Review – Sri Lanka.*** 89 p. No. E.04.II.D.19 \$25***Investment Policy Review – Algeria.*** 110 p. Sales No. F04.II.D.30. \$25.***Investment Policy Review – Nepal.*** 89 p. Sales No. E.03.II.D.17. \$20.***Investment Policy Review – Lesotho.*** 105 p. Sales No. E.03.II.D.18. \$15/18.***Investment Policy Review – Ghana.*** 103 p. Sales No. E.02.II.D.20. \$20.***Investment Policy Review – Tanzania.*** 109 p. Sales No. E.02.II.D.6 \$20.***Investment Policy Review – Botswana.*** 107 p. Sales No. E.01.II.D.I. \$22.***Investment Policy Review – Ecuador.*** 136 p. Sales No. E.01.II D.31. \$25.***Investment and Innovation Policy Review – Ethiopia.*** 130 p. UNCTAD/ITE/IPC/Misc.4.

*Investment Policy Review – Mauritius.* 92 p. Sales No. E.01.II.D.11. \$22.

*Investment Policy Review – Peru.* 109 p. Sales No. E.00.II.D.7. \$22.

*Investment Policy Review – Egypt.* 119 p. Sales No. E.99.II.D.20. \$19.

*Investment Policy Review – Uganda.* 71 p. Sales No. E.99.II.D.24. \$15.

*Investment Policy Review – Uzbekistan.* 65 p. UNCTAD/ITE/IIP/Misc. 13.

#### ***International Investment Instruments***

(For more information visit <http://www.unctad.org/iiia>)

*International Investment Instruments: A Compendium. Vol. XIV.* Sales No. E.05.II.D.8. 326 p. \$60.

*International Investment Instruments: A Compendium. Vol. XIII.* Sales No. E.05.II.D.7. 358 p. \$60.

*International Investment Instruments: A Compendium. Vol. XII.* Sales No. E.04.II.D.10. 364 p. \$60.

*International Investment Instruments: A Compendium. Vol. XI.* 345 p. Sales No. E.04.II.D.9. \$60. [http://www.unctad.org/en/docs/dite4volxi\\_en.pdf](http://www.unctad.org/en/docs/dite4volxi_en.pdf)

*International Investment Instruments: A Compendium. Vol. X.* 353 p. Sales No. E.02.II.D.21. \$60. <http://www.unctad.org/en/docs/psdited3v9.en.pdf>

*International Investment Instruments: A Compendium. Vol. IX.* 353 p. Sales No. E.02.II.D.16. \$60. <http://www.unctad.org/en/docs/psdited3v9.en.pdf>

*International Investment Instruments: A Compendium. Vol. VIII.* 335 p. Sales No. E.02.II.D.15. \$60. <http://www.unctad.org/en/docs/psdited3v8.en.pdf>

*International Investment Instruments: A Compendium. Vol. VII.* 339 p. Sales No. E.02.II.D.14. \$60. <http://www.unctad.org/en/docs/psdited3v7.en.pdf>



*International Investment Instruments: A Compendium. Vol. VI.* 568 p. Sales No. E.01.II.D.34. \$60. [http://www.unctad.org/en/docs/ps1dited2v6\\_p1.en.pdf](http://www.unctad.org/en/docs/ps1dited2v6_p1.en.pdf) (part one).

*International Investment Instruments: A Compendium. Vol. V.* 505 p. Sales No. E.00.II.D.14. \$55.

*International Investment Instruments: A Compendium. Vol. IV.* 319 p. Sales No. E.00.II.D.13. \$55.

### **UNCTAD Investment Guides**

(For more information visit

<http://www.unctad.org/Templates/Page.asp?intItemID=2705&lang=14>)

*An Investment Guide to Rwanda: Opportunities and Conditions.* 79 p. UNCTAD/ITE/IIA/2006/3.

*An Investment Guide to Mali: Opportunities and Conditions.* 68 p. UNCTAD/ITE/IIA/2006/2.

*An Investment Guide to Kenya: Opportunities and Conditions.* 92 p. UNCTAD/ITE/IIA/2005/2.

*An Investment Guide to Tanzania: Opportunities and Conditions.* 82 p. UNCTAD/ITE/IIA/2005/3.

*An Investment Guide to the East African Community: Opportunities and Conditions.* 109 p. UNCTAD/ITE/IIA/2005/4.

*An Investment Guide to Mauritania: Opportunities and Conditions.* 80 p. UNCTAD/ITE/IIA/2004/4.

*Guide de l'investissement au Mali: Opportunités et Conditions.* 76 p. UNCTAD/ITE/IIA/2004/1.

*An Investment Guide to Cambodia: Opportunities and Conditions.* 89 p.  
UNCTAD/ITE/IIA/2003/6.  
[http://www.unctad.org/en/docs/iteiia20036\\_en.pdf](http://www.unctad.org/en/docs/iteiia20036_en.pdf).

*An Investment Guide to Nepal: Opportunities and Conditions.* 97 p.  
UNCTAD/ITE/IIA/2003/2. [http://www.unctad.org/en/docs/iteiia20032\\_en.pdf](http://www.unctad.org/en/docs/iteiia20032_en.pdf).

*An Investment Guide to Mozambique: Opportunities and Conditions.* 109 p.  
UNCTAD/ITE/IIA/4. <http://www.unctad.org/en/docs/poiteiid4.en.pdf>.

*An Investment Guide to Uganda: Opportunities and Conditions.* 89 p.  
UNCTAD/ITE/IIA/2004/3.

*An Investment Guide to Bangladesh: Opportunities and Conditions.* 66 p.  
UNCTAD/ITE/IIT/Misc.29.  
<http://www.unctad.org/en/docs/poiteiitm29.en.pdf>.

*An Investment Guide to Ethiopia: Opportunities and Conditions.* 90 p.  
UNCTAD/ITE/IIA/2004/2.

***International Investment Policies for Development***  
(For more information visit <http://www.unctad.org/iiia>)

*Identifying Core Elements in Investment Agreements in the APEC Regions.*  
134 p. Sales no. E.08.II.D.27. \$15.

*International Investment Rule-Making: Stocktaking, Challenges and the Way Forward.* 124 p. Sales no. E.08.II.D.1. \$15.

*Investment Promotion Provisions in International Investment Agreements.*  
103 p. Sales no. E.08.II.D.5. \$15.

*Preserving Flexibility in IIAs: The Use of Reservations.* 104 p. Sales no.:  
E.06.II.D.14. \$15.

*International Investment Arrangements: Trends and Emerging Issues.* 110 p.  
Sales No. E.06.II.D.03. \$15.

*Investor-State Disputes Arising from Investment Treaties: A Review.* 106 p.  
Sales No. E.06.II.D.1 \$15

*South-South Cooperation in Investment Arrangements.* 108 p. Sales No.  
E.05.II.D.26 \$15.

*International Investment Agreements in Services.* 119 p. Sales No. E.05.II.D.15.  
\$15.

*The REIO Exception in MFN Treatment Clauses.* 92 p. Sales No. E.05.II.D.1.  
\$15.

***Issues in International Investment Agreements***

(For more information visit <http://www.unctad.org/ia>)

*International Investment Agreements: Key Issues, Volumes I, II and III.* Sales  
no.: E.05.II.D.6. \$65.

*State Contracts.* 84 p. Sales No. E.05.II.D.5. \$15.

*Competition.* 112 p. E.04.II.D.44. \$ 15.

*Key Terms and Concepts in IIAs: a Glossary.* 232 p. Sales No. E.04.II.D.31. \$15.

*Incentives.* 108 p. Sales No. E.04.II.D.6. \$15.

*Transparency.* 118 p. Sales No. E.04.II.D.7. \$15.

*Dispute Settlement: State-State.* 101 p. Sales No. E.03.II.D.6. \$15.

*Dispute Settlement: Investor-State.* 125 p. Sales No. E.03.II.D.5. \$15.

*Transfer of Technology.* 138 p. Sales No. E.01.II.D.33. \$18.

*Illicit Payments.* 108 p. Sales No. E.01.II.D.20. \$13.

*Home Country Measures.* 96 p. Sales No. E.01.II.D.19. \$12.

*Host Country Operational Measures.* 109 p. Sales No. E.01.II.D.18. \$15.

*Social Responsibility.* 91 p. Sales No. E.01.II.D.4. \$15.

*Environment.* 105 p. Sales No. E.01.II.D.3. \$15.

*Transfer of Funds.* 68 p. Sales No. E.00.II.D.27. \$12.

*Flexibility for Development.* 185 p. Sales No. E.00.II.D.6. \$15.

*Employment.* 69 p. Sales No. E.00.II.D.15. \$12.

*Taxation.* 111 p. Sales No. E.00.II.D.5. \$12.

*Taking of Property.* 83 p. Sales No. E.00.II.D.4. \$12.

*National Treatment.* 94 p. Sales No. E.99.II.D.16. \$12.

*Admission and Establishment.* 69 p. Sales No. E.99.II.D.10. \$12.

*Trends in International Investment Agreements: An Overview.* 133 p. Sales No. E.99.II.D.23. \$12.

*Lessons from the MAI.* 52 p. Sales No. E.99.II.D.26. \$10.

*Fair and Equitable Treatment.* 85 p. Sales No. E.99.II.D.15. \$12.

*Transfer Pricing.* 71 p. Sales No. E.99.II.D.8. \$12.

*Scope and Definition.* 93 p. Sales No. E.99.II.D.9. \$12.

*Most-Favoured Nation Treatment.* 57 p. Sales No. E.99.II.D.11. \$12.

*Investment-Related Trade Measures.* 57 p. Sales No. E.99.II.D.12. \$12.

*Foreign Direct Investment and Development.* 74 p. Sales No. E.98.II.D.15. \$12.

## B. INVESTMENT ADVISORY SERVICES

Series A. No. 1. *Aftercare: A Core Function In Investment Promotion.* UNCTAD/ITE/IPC/2007/1 (October 2007).

Series A. No. 2. *Shaping the Investment Climate: The IPA as Policy Advocate* (forthcoming).

No. 18. *A Survey of Support by Investment Promotion Agencies to Linkages.* UNCTAD/ITE/IPC/2005/12. ISSN: 1819-5938

## C. INDIVIDUAL STUDIES

*Investor-State Dispute Settlement and Impact on Investment Rulemaking.* 110 p. Sales No. E.07.II.D.10. \$30.

*Bilateral Investment Treaties 1995—2006: Trends in Investment Rulemaking.* 172 p. Sales No. E.06.II.D.16. \$30.

*Investment Provisions in Economic Integration Agreements.* 174 p. UNCTAD/ITE/IIT/2005/10.

*Globalization of R&D and Developing Countries.* 242 p. Sales No. E.06.II.D.2. \$35.

*Prospects for Foreign Direct Investment and the Strategies of Transnational Corporations, 2005-2008.* 74 p. Sales No. E.05.II.D.32. \$18.

*World Economic Situation and Prospects 2005.* 136 p. Sales No. E. 05.II.C.2. \$15. (Joint publication with the United Nations Department of Economic and Social Affairs.)

*Foreign Direct Investment and Performance Requirements: New Evidence from Selected Countries.* 318 p. Sales No. E.03.II.D.32. \$35. [http://www.unctad.org/en/docs//iteiia20037\\_en.pdf](http://www.unctad.org/en/docs//iteiia20037_en.pdf)

*FDI in Land-Locked Developing Countries at a Glance.* 112 p. UNCTAD/ITE/IIA/2003/5.

*FDI in Least Developed Countries at a Glance: 2002.* 136 p. UNCTAD/ITE/IIA/6. [http://www.unctad.org/en/docs//iteiia6\\_en.pdf](http://www.unctad.org/en/docs//iteiia6_en.pdf).

*Foreign Direct Investment in Africa: Performance and Potential.* 89 p. UNCTAD/ITE/IIT/Misc.15. Free of charge. Also available from <http://www.unctad.org/en/docs/poiteiitm15.pdf>.

*TNC-SME Linkages for Development: Issues–Experiences–Best Practices. Proceedings of the Special Round Table on TNCs, SMEs and Development, UNCTAD X, 15 February 2000, Bangkok, Thailand.* 113 p. UNCTAD/ITE/TEB1. Free of charge.

*Measures of the Transnationalization of Economic Activity.* 93 p. Sales No. E.01.II.D.2. \$20.

*The Competitiveness Challenge: Transnational Corporations and Industrial Restructuring in Developing Countries.* 283p. Sales No. E.00.II.D.35. \$42.

*FDI Determinants and TNC Strategies: The Case of Brazil.* 195 p. Sales No. E.00.II.D.2. \$35. Summary available from <http://www.unctad.org/en/pub/psiteiitd14.en.htm>.

#### *Studies on FDI and Development*

*TNCs and the Removal of Textiles and Clothing Quotas.* 78 p. Sales No. E.05.II.D.20.

*Measuring Restrictions on FDI in Services and Transition Economies,* 56 p. Sales No. 06.II.D.13.

---

---

#### D. JOURNALS

*Transnational Corporations Journal* (formerly *The CTC Reporter*).  
Published three times a year. Annual subscription price: \$45; individual issues \$20. [http://www.unctad.org/en/subsites/dite/1\\_itncs/1\\_tncs.htm](http://www.unctad.org/en/subsites/dite/1_itncs/1_tncs.htm).

United Nations publications may be obtained from bookstores and distributors throughout the world. Please consult your bookstore or write:

For Africa, Asia and Europe to:

Sales Section  
United Nations Office at Geneva  
Palais des Nations  
CH-1211 Geneva 10  
Switzerland  
Tel: (41-22) 917-1234  
Fax: (41-22) 917-0123  
E-mail: [unpubli@unog.ch](mailto:unpubli@unog.ch)

For Asia and the Pacific, the Caribbean, Latin America and North America to:

Sales Section  
Room DC2-0853  
United Nations Secretariat  
New York, NY 10017  
United States  
Tel: (1-212) 963-8302 or (800) 253-9646  
Fax: (1-212) 963-3489  
E-mail: [publications@un.org](mailto:publications@un.org)

All prices are quoted in United States dollars.

For further information on the work of the Division on Investment, Technology and Enterprise Development, UNCTAD, please address inquiries to:

United Nations Conference on Trade and Development  
Division on Investment and Enterprise  
Palais des Nations, Room E-10054  
CH-1211 Geneva 10, Switzerland  
Telephone: (41-22) 917-5651  
Telefax: (41-22) 917-0498  
<http://www.unctad.org>



# QUESTIONNAIRE

## The Protection of National Security in IIAs

Sales No. E.09.II.D.

In order to improve the quality and relevance of the work of the UNCTAD Division on Investment, Technology and Enterprise Development, it would be useful to receive the views of readers on this publication. It would therefore be greatly appreciated if you could complete the following questionnaire and return it to:

Readership Survey  
UNCTAD Division on Investment and Enterprise  
United Nations Office at Geneva  
Palais des Nations, Room E-9123  
CH-1211 Geneva 10, Switzerland  
Fax: 41-22-917-0194

1. Name and address of respondent (optional):  
\_\_\_\_\_  
\_\_\_\_\_
  
2. Which of the following best describes your area of work?

Government	<input type="checkbox"/>	Public enterprise	<input type="checkbox"/>
Private enterprise	<input type="checkbox"/>	Academic or research institution	<input type="checkbox"/>
International organization	<input type="checkbox"/>	Media	<input type="checkbox"/>
Not-for-profit organization	<input type="checkbox"/>	Other (specify) _____	
  
3. In which country do you work? \_\_\_\_\_
  
4. What is your assessment of the contents of this publication?

Excellent	<input type="checkbox"/>	Adequate	<input type="checkbox"/>
Good	<input type="checkbox"/>	Poor	<input type="checkbox"/>

5. How useful is this publication to your work?

Very useful	<input type="checkbox"/>	Somewhat useful	<input type="checkbox"/>
Irrelevant	<input type="checkbox"/>		

6. Please indicate the three things you liked best about this publication:

---



---



---

7. Please indicate the three things you liked least about this publication:

---



---



---

8. If you have read other publications of the UNCTAD Division on Investment, Enterprise Development and Technology, what is your overall assessment of them?

Consistently good	<input type="checkbox"/>	Usually good, but with some exceptions	<input type="checkbox"/>
Generally mediocre	<input type="checkbox"/>	Poor	<input type="checkbox"/>

9. On average, how useful are those publications to you in your work?

Very useful	<input type="checkbox"/>	Somewhat useful	<input type="checkbox"/>
Irrelevant	<input type="checkbox"/>		

- 
10. Are you a regular recipient of *Transnational Corporations* (formerly *The CTC Reporter*), UNCTAD-DITE's tri-annual refereed journal?

Yes

No

If not, please check here if you would like to receive a sample copy sent to the name and address you have given above:

