

Fordham International Law Journal

Volume 38, Issue 1

2015

Article 13

Beyond Self-Judgment: Exceptions Clauses in US Bits

Catherine*

*Covington & Burling, LLP

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CLAUSES IN US BITS

*Catherine H. Gibson**

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* Associate, Covington & Burling, LLP and former Legal Adviser, Iran-US Claims Tribunal. Many thanks to Kamal Javadi, Charles B. Rosenberg, and the staff of the *Fordham International Law Journal* for their helpful comments. This Article reflects the views of the Author alone, and not necessarily those of Covington & Burling, LLP or the Iran-US Claims Tribunal.

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INTRODUCTION

The United States is now negotiating its most important bilateral investment treaty (“BIT”) to date, a BIT with China.¹ In July 2013, the two States made the “[b]reakthrough [a]nnouncement” that these negotiations would begin.² Since then, former officials from both States have touted the benefits of this treaty, stating that it will “unleash far more investment in both directions,” move China toward a balanced, service-based economy, and infuse capital into the US economy to spur growth.³

The treaty will also mean more work for lawyers, particularly those lawyers defending the United States and China in investment arbitrations brought by investors of the other State. As the United States has learned in its experience with the North American Free Trade Agreement (“NAFTA”), the inclusion of investor-State dispute settlement provisions in an investment agreement will inevitably lead to the initiation of investment arbitration proceedings, and if nationals of the US treaty partner have investments in the United States, those arbitrations will be filed against the United States.⁴ Indeed, precisely this has been the result in the years following the conclusion of the NAFTA. The United States and Canada have faced 34 arbitrations between each other, a consequence wholly unforeseen by the

1. For general background on the bilateral investment (“BIT”) policies of China and the United States, as well as anticipated areas of disagreement in the US-China BIT negotiations, see W.H. Maruyama, J.T. Stoel & C.B. Rosenberg, *Negotiating the US-China Bilateral Investment Treaty: Investment Issues and Opportunities in the Twenty-First Century*, 7(4) *TRANSNAT’L DISP. MGMT.* (2010).

2. Betsy Bourasa, US Dep’t of the Treasury, *US and China Breakthrough Announcement on the Bilateral Investment Treaty Negotiations*, *TREASURY NOTES BLOG* (July 15, 2013), <http://www.treasury.gov/connect/blog/Pages/US-and-China-Breakthrough-Announcement-.aspx>.

3. Charlene Barshefsky & Long Yongtu, *A Win-Win Possibility for China-US Trade*, *WALL ST. J.*, June 30, 2014.

4. That is, of course, assuming that the treaty includes investor-State dispute settlement. Such an assumption seems safe because China’s recent agreements have included investor-State dispute settlement, and the United States has shown no sign of backing away from its longstanding policy of supporting investor-State dispute settlement.

negotiators of either State when deciding to include investor-State dispute settlement provisions and wholly unavoidable, once the United States and Canada signed the treaty.⁵

Chinese investors are already heavily involved in the US economy,⁶ and this involvement will only increase with the conclusion of the US-China BIT.⁷ Thus, the United States will inevitably find itself in the coming years acting as a respondent in investor-State arbitrations brought by Chinese investors under the forthcoming US-China treaty. US treaty negotiators would be well advised to ensure that the United States can maintain the desirable level of regulatory flexibility in this treaty, while still providing the promised investment protections. Arbitral tribunals, while a useful mechanism for settling disputes, are notoriously unpredictable and—for better or worse—tribunals are not bound by precedent.⁸ Therefore,

5. As one commentator has observed, while the “novelty” of including investor-state dispute settlement as between the United States and Canada in NAFTA was noted at the time, “its implications were not fully appreciated.” William S. Dodge, *Investor-State Dispute Settlement Between Developed Countries: Reflections on the Australia-United States Free Trade Agreement*, 39 VAND. J. TRANSNAT’L L. 1, 16 (2006). This view is confirmed by numerous statements by US officials at the time investment arbitrations were unfolding against the United States under NAFTA. See Adam Liptak, *Review of US Rulings by NAFTA Tribunals Stirs Worries*, N.Y. TIMES, Apr. 18, 2004. Indeed, the US experience as a respondent in various NAFTA arbitrations shaped the 2004 Model BIT. Lee M. Caplan & Jeremy K. Sharpe, *United States*, in SELECTED COMMENTARIES ON MODEL INVESTMENT TREATIES 756 (Chester Brown ed., 2013). Due to concern that “arbitral tribunals might misinterpret certain [NAFTA] Chapter 11 obligations that were formulated in minimalist terms” the United States clarified certain obligations in the 2004 Model BIT which were previously left undefined. *Id.*

6. As reported in *Business Week*, Chinese companies invested US\$14 billion in the United States in 2013, particularly in the areas of food, real estate, and energy. Dexter Roberts, *Chinese Investment in US Doubles to \$14 Billion in 2013*, BLOOMBERG BUSINESS WEEK (Jan. 8, 2014), <http://www.businessweek.com/articles/2014-01-08/chinese-investment-into-u-dot-s-dot-doubles-to-14-billion-in-2013>; see also US Chamber of Commerce, *Faces of Chinese Investment in the United States*, available at https://www.uschamber.com/sites/default/files/legacy/reports/16983_INTL_FacesChineseInvest_copyright_lr.pdf (last visited August 19, 2014).

7. Future investments would of course be covered by investment treaty protections, and therefore could form the subject of an investment dispute if affected by host-State measures. Under the 2012 US Model BIT, investments that predate the treaty are also protected (as “covered investments”), and could also serve as a basis for an investment dispute, if affected by host-State measures. See 2012 US Model BIT art. 1, available at <http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf>. (“‘Covered investment’ means, with respect to a Party, an investment in its territory of an investor of the other Party in existence as of the date of entry into force of this Treaty or established, acquired, or expanded thereafter.”)

8. See Ragnar Harbst et al., *Germany*, in BAKER & MCKENZIE INTERNATIONAL YEARBOOK: 2011-2012 196 (2012).

the best vehicle to ensure the appropriate level of regulatory flexibility is the BIT itself, and in particular the inclusion of exceptions clauses that permit the host State to take certain measures that otherwise would be in violation of the investment treaty.⁹ These clauses—which are treated as a whole in this article as exceptions clauses—are on the rise in investment treaties generally, and US negotiators would be wise to follow this trend and consider the exceptions provided in its BIT with China and the language of those exceptions.

Much has been written about necessity and related treaty exceptions with respect to the investment claims against Argentina¹⁰ and in the context of the security exception of the General Agreement on Tariffs and Trade.¹¹ What is lacking, however, is a proposal on the way forward for US negotiators seeking to set out exceptions clauses in the BIT with China and other future treaty partners. Such a proposal may be drawn from the interpretation of necessity in customary international law by investment tribunals and a comparative analysis of other States' approaches to exceptions clauses in investment treaties. This Article conducts the underlying analysis and provides such a proposal.

This Article proceeds as follows: Part I analyzes necessity under customary international law and emphasizes the extremely narrow and questionable nature of this plea and the difficulty of applying it in investment disputes. Part II describes the evolution of exceptions clauses in US BIT practice and notes problems with the three different, disparate types of exceptions clauses in current US BITs. Part III provides a comparative perspective by describing the

9. Indeed, such a clause would be in line with other provisions of recent model BITs which reduce the discretion of arbitral tribunals in favor of more State-to-State control of the standards applied in the arbitral process. For example, the United States has defined the “fair and equitable treatment” standard according to the customary international law minimum standard of treatment, and set out that ordinary regulatory measures do not constitute expropriation. See O. Thomas Johnson & Catherine H. Gibson, *The Objections of Developed and Developing States to Investor-State Dispute Resolution*, in *CONTEMPORARY ISSUES IN INTERNATIONAL ARBITRATION AND MEDIATION: THE FORDHAM PAPERS* (Arthur W. Rovine ed., forthcoming 2014).

10. E.g., Jose E. Alvarez & Tegan Brink, *Revising the Necessity Defense: Continental Casualty v. Argentina*, in *YEARBOOK ON INT'L INV. LAW & POLICY* (Karl P. Sauvant ed., 2011); William W. Burke-White & Andreas von Staden, *Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties*, 48 *VA. J. INT'L L.* 307 (2008).

11. E.g., Roger P. Alford, *The Self-Judging WTO Security Exception*, 2011 *UTAH L. REV.* 697 (2011).

exceptions clauses in the BITs of other States, noting the advantages and disadvantages of these alternative approaches. Part IV suggests a way forward for the United States in its BIT negotiations, particularly its negotiation with China, by combining lessons learned from the weaknesses of existing US BIT exceptions clauses and the advantages of exceptions clauses from other States.

I. 'NECESSITY' IN CUSTOMARY INTERNATIONAL LAW

A current discussion of 'necessity' in customary international law must begin with Article 25 of the Draft Articles on Responsibility of States for Internationally Wrongful Acts ("Draft Articles") by the International Law Commission ("ILC"). As discussed below, the concept of necessity in Article 25 is quite narrow, particularly as applied and interpreted in the investment context. In addition, fundamental questions remain regarding the status and availability of this defense in customary international law generally, and particularly outside a situation of war.

A. ILC Draft Article 25—Six Requirements

The necessity provision at Article 25 of the ILC Draft Articles provides:

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.¹²

12. U.N. Int'l Law Comm'n, *Draft Articles on Responsibility of States for Internationally Wrongful Acts*, art. 25, U.N. Doc. A/56/10 (2001).

As this text makes clear, a State must fulfill six criteria in order to successfully plead necessity: (1) a threat to an “essential interest” of a particular State; (2) a “grave and imminent peril” to that interest; (3) the action taken is the “only way” to preserve that essential interest; (4) that the situation in question was not caused by the State seeking to invoke the plea; (5) the State’s action to address the situation does not impair the interests of other States; and (6) the action lasts only as long as the situation persists.

The difficulty of applying this provision in investment arbitrations has been amply demonstrated in the arbitral proceedings brought against Argentina arising out of the financial crisis it suffered in the late 1990s.¹³ In the early 1990s, Argentina sought to attract foreign investment by, among other measures, privatizing its gas sector. In so doing, Argentina promised foreign investors certain benefits, including regular payments calculated in US dollars. When its financial crisis struck in the late 1990s, Argentina suspended and ultimately reversed these laws favorable to foreign investors, and multiple arbitrations were filed, only a fraction of which have been concluded. In those arbitrations—some of which were filed under the US-Argentina BIT—Argentina famously invoked necessity under customary international law to avoid responsibility under the BIT.¹⁴ The arbitral panels deciding these cases stirred some controversy by applying different interpretations of the necessity plea, and, on some issues, even reaching wholly conflicting decisions. Adding to this controversy, the annulment committees considering the panel decisions in the cases against Argentina have reached still different conclusions regarding the interpretation and application of the plea. As discussed further below, some of the problems with these decisions were caused by the fact that the ILC provision is simply incongruent with the arbitration paradigm.

To excuse or justify an internationally wrongful act with a plea of necessity, a State must first show that the act it took was in defense

13. See *LG&E Energy Corp. v. Arg. Republic*, ICSID Case No. ARB/02/1, Decision on Liability (Oct. 3, 2006) [hereinafter *LG&E Award*]; *CMS Transmission Co. v. Arg. Republic*, ICSID Case No. ARB/01/8, Award (May 12, 2005) [hereinafter *CMS Award*]; *Enron Corp., Ponderosa Assets, L.P. v. Arg. Republic*, ICSID Case No. ARB/01/3, Award (May 22, 2007) [hereinafter *Enron Award*]; *Sempra Energy Int’l v. Arg. Republic*, Case No. ARB/02/16, Award (Sept. 28, 2007) [hereinafter *Sempra Award*].

14. See *Alvarez & Brink*, *supra* note 10; see also *Burke-White & van Staden*, *supra* note 10 at 314.

of “an essential interest.”¹⁵ An “essential interest” within the meaning of the ILC Draft Articles, is not limited to preservation of the State itself, but rather includes also the preservation of the environment¹⁶ and food supplies.¹⁷ The term is, however, fact-specific: “[t]he extent to which a given interest is ‘essential’ depends upon all the circumstances, and cannot be prejudged. It extends to particular interests of the State and its people, as well as of the international community as a whole.”¹⁸ Indeed, the Argentina cases bear out the fact-specific nature—and perhaps the tribunal-specific nature—of what constitutes an “essential interest.” An arbitral panel considering one of these cases stated that an interest is “essential” if it implicates the State’s very existence and independence. This panel acknowledged that Argentina’s financial crisis was “severe” and that “in such a context it was unlikely that business could have continued as usual.”¹⁹ Ultimately, however, the Tribunal held that Argentina’s financial crisis did not threaten an essential interest of the State because “[q]uestions of public order and social unrest could have been handled, as in fact they were, just as questions of political stabilization were handled under the constitutional arrangements in force.”²⁰

A different arbitral panel considering exactly the same Argentine financial crisis, however, concluded that Argentina *had* faced a threat to an essential interest within the meaning of Article 25 of the ILC Draft Articles. As that panel reasoned, during the financial crisis

15. The International Law Commission (“ILC”) Draft Articles do not state clearly whether Article 25 constitutes a justification, so that liability does not attach, or an excuse, such that liability does attach but is excused. See Robert Sloane, *On the Use and Abuse of Necessity in the Law of State Responsibility*, 106 AM. J. INT’L L. 447, 482-86 (2012) (noting the lack of clarity on this point in the ILC Draft Articles and stating that “the effects of necessity may differ contextually”).

16. The Gabčíkovo-Nagymaros Project (Hung./Slovk.), 1997 I.C.J. 7 (Sept. 25).

17. R. Ago, *Addendum to the Eighth Report on State Responsibility*, [1980] Y.B. Int’l L. Comm’n 13, U.N. Doc. A/CN.4/SER.A/1980/Add. 1. Although its exact scope is not clear, the term essential interest is certainly broader than the “peremptory norms of general international law” addressed at articles 40 and 41 and thereafter of the ILC Draft Articles. Sarah Heathcote, *Circumstances Precluding Wrongfulness in the ILC Articles on State Responsibility: Necessity*, in OXFORD COMMENTARIES ON STATE RESPONSIBILITY 491, 497 (2010). Articles 40 and 41 obligate States to “cooperate to bring to an end” “a gross or systematic failure by the responsible State” to fulfill “an obligation arising under a peremptory norm of general international law.” U.N. Int’l Law Comm’n, *supra* note 12, at art. 40–41.

18. JAMES CRAWFORD, THE INTERNATIONAL LAW COMMISSION’S ARTICLES ON STATE RESPONSIBILITY 183 (2002).

19. *Sempra Award*, *supra* note 13, ¶ 348.

20. *Id.*

Argentina “faced an extremely serious threat to its existence, its political and economic survival, to the possibility of maintaining its essential services in operation, and to the preservation of its internal peace.”²¹ Interestingly, both panels define an “essential interest” in the same way, but they reach different conclusions on the facts. Thus, as the Argentina cases demonstrate, the existence of an essential interest under Draft Article 25—even when the definition of that term is agreed—is not a matter of black and white, and different arbitral panels can reach different decisions on whether the interests at stake in particular circumstances are “essential.”

Even if an essential interest is at issue, a State seeking to invoke necessity must also demonstrate that this essential interest was threatened by grave and imminent peril. Such a showing requires concrete evidence: “The peril has to be objectively established and not merely apprehended as possible.”²² However, some preemptive action is permitted, a fact that distinguishes acts of necessity from acts of mitigation.²³ Thus, “a measure of uncertainty about the future does not necessarily disqualify a State from invoking necessity, if the peril is clearly established on the basis of the evidence reasonably available at the time.”²⁴ In the Argentina cases, however, this factor has been applied strictly, seemingly allowing very little preemptive action. One panel, for example, took the view that fulfilling this “peril” factor would involve a finding that matters were out of control. Thus, the tribunal held that Argentina had not met the “peril” requirement for the necessity plea because “[w]hile the [Argentine] Government had a duty to prevent a worsening of the situation, and could not simply leave events to follow their own course, there is no convincing evidence that events were actually out of control or had become unmanageable.”²⁵

Even if a State has satisfied the “essential interest” and “grave and imminent peril” factors, the State can successfully plead necessity under the ILC Draft Articles only if the act in question was the “only way” to safeguard the essential interest at stake. As stated in the ILC commentary, “[t]he plea is excluded if there are other (otherwise

21. *LG&E Award*, *supra* note 13, ¶ 257.

22. CRAWFORD, *supra* note 18, at 183.

23. *The Gabčíkovo–Nagymaros Project (Hung./Slovk.)*, 1997 I.C.J. 7, ¶ 55–56 (Sept. 25).

24. CRAWFORD, *supra* note 18, at 184.

25. *Sempra Award*, *supra* note 13, ¶ 349.

lawful) means available” and moreover, “[t]he word ‘way’ . . . is not limited to unilateral action but may also comprise other forms of conduct available through cooperative action with other States or through international organizations.”²⁶

In applying this “only way” factor, investment tribunals considering the Argentina cases have declined to second-guess government action in emergency situations.²⁷ Instead, one panel took a comparative approach and found that Argentina’s action in addressing its financial crisis was not the “only” way to do so. As this tribunal reasoned, “[a] rather sad global comparison of experiences in the handling of economic crises shows that there are always many approaches to addressing and resolving such critical events” and therefore the tribunal found it “difficult to justify the position that only one of them was available in the Argentine case.”²⁸ Under this analysis, seemingly no State could ever successfully plead necessity in a financial crisis because economic theory will never offer a single theory to address a financial crisis.

In addition to the above criteria, which relate to the character of the action in question, the ILC Draft Articles’ necessity provision also includes criteria related to the emergency itself and the State’s other actions. In particular, the State seeking to invoke the plea must not have contributed to the emergency situation. The inclusion of this factor—along the lines of a clean-hands requirement—discourages abuse of the necessity plea by preventing a State from manufacturing an emergency situation in order to extricate itself from an onerous international obligation. This is an admirable goal, but as the Argentina cases have demonstrated the myriad of factors that mix in unforeseeable ways to form an economic crisis have rendered this “non-contribution” factor nearly impossible to satisfy in the context of a financial crisis. As one Argentina panel stated, as to financial crises in general, “the roots extend both ways and include a number of domestic as well as international dimensions” as the “unavoidable consequence of the operation of a global economy where domestic and international factors interact.”²⁹

In addition to the clean-hands requirement of non-contribution, the ILC’s necessity provision requires a balancing of

26. CRAWFORD, *supra* note 18, at 184.

27. *CMS Award*, *supra* note 13, ¶ 323.

28. *Sempra Award*, *supra* note 13, ¶ 350.

29. *CMS Award*, *supra* note 13, ¶ 328.

interests of other States and the international community as a whole. Thus, the ILC provision requires that “the interests relied on [by the State pleading necessity] must outweigh all other considerations, not merely from the point of view of the acting State, but on a reasonable assessment of the competing interests, whether these are individual or collective.”³⁰ When a necessity plea is invoked in State-to-State cases, this balancing factor reflects the principle of sovereign equality of nations—one State may not take action to protect its own interests in a manner that disproportionately harms the interests of other States, because all States are of equal sovereignty and their interests enjoy equal importance on the international plane.

In the investor-State context, however, where the principle of sovereign equality is inapplicable, the proper interpretation of this balancing factor is unclear. One Argentina panel took a novel approach to this question—and an approach that makes it extremely difficult for the responding State to satisfy the requirements for the necessity plea.³¹ In applying the balancing-of-interests factor, the tribunal first considered whether the action compromised the interest of the other State party to the investment treaty, and then also whether the action compromised the interest of the investor. Although that tribunal ultimately concluded that any compromise to other interests did not preclude Argentina’s invocation of the necessity plea under the ILC Draft Articles,³² the panel’s consideration of the interests of a

30. CRAWFORD, *supra* note 18, at 184.

31. The CMS tribunal considered the “other interests” criterion of the ILC Draft Articles in the context of the non-precluded measures provision of the United States-Argentina BIT, which Argentina had also invoked in that case. *See CMS Award, supra* note 13, ¶325. The annulment committee criticized the panel’s intermingling of these two standards. *See CMS Gas Transmission Co. v. Arg. Republic, ICSID Case No. ARB/01/8, Decision on Annulment, ¶¶ 128–36 (Sept. 25, 2007).*

32. As the tribunal stated, “it does not appear that an essential interest of the State to which the obligation exists has been impaired, nor have those of the international community as a whole.” *CMS Award, supra* note 13, ¶ 358. This approach is largely echoed in the *Sempra Award*. There, the tribunal stated that “[t]he interest of the international community does not appear to be in any way impaired in this context, as it is an interest of a general kind.” *Sempra Award, supra* note 13, ¶ 352. The *Sempra Award* tribunal also found that the invocation of the state of necessity would not impair the interest of the other state-party to the investment treaty. *Sempra Award, supra* note 13, ¶ 390. *Sempra Award* discussed this matter as part of its analysis of the non-precluded measures clause of the US-Argentina BIT because the tribunal found that the BIT “did not deal with the elements necessary for the legitimate invocation of a state of necessity.” *Sempra Award, supra* note 13, ¶ 378. Like the *CMS Award* tribunal, the *Sempra Award* tribunal also considered the interests of investors because they are “ultimately the beneficiaries of [investment treaty] obligations.” *Sempra Award, supra* note 13, ¶ 391. The

private investor, as well as the interests of the other State party to the investment treaty, makes it extremely difficult for the State seeking to invoke necessity to satisfy the customary international law requirements of that plea. Indeed, an investment will seemingly always be an “essential interest” to an investor, and the investor’s decision to initiate an arbitration indicates that this interest has been compromised—thus, if an investor’s interests are weighed equally against those of host States, then the host State could satisfy the necessity plea only when the host State’s action did not negatively affect the investment—in which case seemingly the host State would not have violated the investment treaty in the first place.

Finally, a plea of necessity also is limited in time and applies only so long as the emergency situation persists. In other words “any conduct going beyond what is strictly necessary for the purpose will not be covered.”³³ This limitation, in contrast to the prior five factors, actually causes relatively little trouble in investment disputes. Although it will sometimes be difficult to fix the exact date on which a situation of “financial emergency” ceases, a reasonableness test could be applied in these circumstances.

B. *Problems with ‘Necessity’ in Investment Cases*

As the foregoing discussion demonstrates, the ILC Draft Articles’ necessity provision is unwieldy in its application to financial emergencies, as pled in investor-State arbitrations. At least three problems are presented in the foregoing discussion.

First, arbitral tribunals have been inconsistent in their findings regarding whether an “essential interest” is at stake when a State is facing a severe financial crisis. Addressing the exact same financial crisis and indeed seemingly applying the same standard, tribunals considering claims against Argentina reached differing conclusions on whether Argentina was protecting an “essential interest” in the actions it took in response to its financial crisis. With such inconsistency in interpretation, a State cannot be sure whether this provision would be applied in the sense of customary international law in any given case. Indeed, this finding more than any other, illustrates the dangers of imprecision in treaty-drafting—with such

tribunal concluded, without analysis, that the essential interest of the claimant investor “would certainly be seriously impaired by the operation of . . . a state of necessity in this case.” *Id.*

33. CRAWFORD, *supra* note 18, at 184.

imprecision, the treaty parties cannot predict how treaty provisions will be interpreted, and they cannot even be sure that a single provision will be given a single, consistent interpretation.

An additional problem is presented by arbitral tribunals' interpretation of the "only way" and "clean hands" requirements—interpretations of these requirements make it difficult for any State to ever successfully plead necessity under customary international law. As to the "only way" requirement, because economic theory will always present alternative ways to achieve a certain result (at least hypothetically), tribunals' consideration of such hypothetical alternatives will preclude a finding that certain action is ever excused or justified by necessity. As to the "clean hands" requirement—that the State seeking to invoke the necessity plea must not have contributed to the situation of necessity—arbitral tribunals seem to have recognized the difficulty that this requirement causes for States, and therefore have weighed the relative contribution of the State to the situation of necessity.³⁴

Finally, the application of the balancing factor is difficult in the investment arbitration context, which presents claims of a private investor against a State, based on a State-to-State treaty. Consideration of the investors' interests in the balancing factor may be difficult to justify, particularly if the inclusion of this factor in the ILC draft articles was to reflect principles of sovereign equality.³⁵ Moreover, consideration of the investors' interests will *always* preclude a State from invoking the necessity plea because the investor's interests will almost *by definition* have been compromised—indeed, an allegation that the investor's interests have been injured is precisely the basis for bringing the investment dispute, and would be the basis of a finding that the host State had violated the substantive terms of the investment treaty. Traditionally, this

34. The *CMS Award* panel, for example, weighed the relative contribution of domestic and international factors to the economic crisis. In this further analysis, the panel concluded that Argentina had contributed to the economic situation to an extent that precluded it from invoking the plea of necessity under customary international law. *CMS Award*, *supra* note 13, ¶ 329. As the tribunal stated, the crisis "found its roots in the earlier crisis of the 1980s and evolving governmental policies of the 1990s that reached a zenith in 2002" and therefore "government policies and their shortcomings significantly contributed to the crisis and the emergency." *Id.* The tribunal was not swayed from this conclusion by the existence of "exogenous factors" that "fuel[ed] additional difficulties." *Id.*

35. And indeed, it is unclear whether such analysis is even appropriate in international law—one commentator has criticized this factor as "wholly foreign to necessity as understood in the early law of nations," Sloane, *supra* note 15, at 458.

discussion of the necessity plea under customary international law occurs in the context of relations between States, not relations between a State and a private citizen, and the context-specific nature of the plea is demonstrated by the difficulty of applying its terms in investment disputes outside the State-to-State context.³⁶

In addition to these problems with the terms of the necessity plea in customary international law, there remains doubt about the scope and indeed the very existence of necessity in customary international law, discussed in the next section.

C. Lingering Controversy

The ILC's records demonstrate that the necessity provision was controversial throughout the drafting phases of the Draft Articles. For example, the Swedish representative acknowledged in 1981 that, "necessity is recognized, in principle, as an admissible plea," but stated that the scope of such a provision was not clearly established so that "each case will have to be judged individually on the basis of moral rather than legal considerations."³⁷ Such calls for fact-specific determinations were echoed by other ILC representatives throughout the negotiating process, and do not inspire confidence that a consensus exists on even the general scope of any such plea.

Particular controversy arose in discussions of using the term "essential interest" to describe what might give rise to a successful invocation of the necessity plea. As a representative from Mongolia stated, "[t]he criterion of an 'essential interest' used in the article not only fails to solve the problem [of vagueness], but may even create new problems. It is virtually impossible to establish whose interests are essential when the interests of two States clash."³⁸ Another representative similarly noted that "[t]he concept of an essential interest which a State might invoke to evade its responsibility was

36. Andrea K. Bjorklund, *Emergency Expectations: State of Necessity and Force Majeure*, in THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 459, 463 (Peter T. Muchlinski, Federico Ortino, & Christoph Schreuer eds., 2008) ("[T]he state of necessity defence is usually discussed in the classic language of responsibility as between States themselves. This lack of congruence is evident when tribunals examining a necessity defence are analyz[ing] the relative interests of a host State and an investor, rather than the relative interests of the host State and the home State.").

37. *Comments of Governments on part one of the draft articles on State responsibility for internationally wrongful acts*, [1981] 2(1) Y.B. Int'l L. Comm'n 77, U.N. Doc. A/CN.4/342 and Add. 1-4.

38. *Id.* at 76.

very subjective. To a State, every one of its interests was essential.”³⁹ Such concerns remain today.

Indeed, even after the ILC’s Draft Articles—including the necessity provision—were adopted, James Crawford wrote that “[i]t has been doubted whether necessity exists as an omnibus category.”⁴⁰ And indeed, these doubts come from diverse and illustrious sources. As stated in the decision of the *Rainbow Warrior* arbitration, “there is no general principle allowing the defence of necessity.”⁴¹ Moreover, as scholars have noted, even if such a plea exists in general international law, “[t]he limits of defences such as necessity in terms of customary international law and its application in the investment context remain to be worked out.”⁴² Indeed, these Draft Articles “were drafted to serve general purposes; they were not drafted to serve the interests of investor-State arbitration, or even of investment generally.”⁴³

The idea of pleading necessity as an exit for international law obligations can be traced to Grotius and Vattel, and even further in history to religious texts.⁴⁴ Early arbitral decisions conflated necessity and *force majeure*, however, and invocations of this plea under circumstances other than war were generally unsuccessful. In the

39. *Draft articles on State responsibility. Texts adopted by the Drafting Committee: articles 33 to 35 - reproduced in document A/CN.4/SR.1635, paras. 42, 53 and 62, [1980] 1 Y.B. Int’l L. Comm’n 271, ¶ 48, U.N. Doc. A/CN.4/L.318.*

40. James Crawford, *BROWNIE’S PRINCIPLES OF PUBLIC INTERNATIONAL LAW* 564 (Oxford University Press 8th ed. 2012)

41. *Fr. v. N.Z.*, 1990 R.I.A.A. 254, ¶ 78 (Apr. 30).

42. M. Sornarajah, *Evolution or Revolution in International Investment Arbitration? The Descent into Normlessness*, in *EVOLUTION IN INVESTMENT TREATY LAW AND ARBITRATION* 631, 656 (Chester Brown & Kate Miles eds., 2011).

43. Bjorklund, *supra* note 36, at 522.

44. As one author has noted, “States recognize the need for a residual ‘exit’ mechanism from legal obligations—the contours of which are as uncertain as the possible contingencies presumably embraced in the [necessity] doctrine.” Diane A. Desierto, *Necessity and National Emergency Clauses Sovereignty in Modern Treaty Interpretation*, in 3 *INTERNATIONAL LITIGATION IN PRACTICE* 116 (Loretta Malintoppi & Eduardo Valencia-Ospina eds., 2012). As Desierto sets out, doctrines of necessity are present in several areas of international law, including human rights and the law of armed conflict, as well as in international investment law and international trade law. She suggests that an additional reason to include a necessity clause in a treaty may be “to prevent abusive or disingenuous invocation of necessity by other treaty parties.” *Id.* at 129. By specifically setting out the scope of a necessity defense, this argument goes, a state may preclude a treaty partner from taking a very broad view of necessity under customary international law. *Id.* at 129–30. This alternative rationale for including a necessity clause is not implausible, but it is also inconsistent with the ILC definition of necessity, which, in fact, appears quite narrow (and narrower than the necessity clauses included in investment treaties).

1912 *Russian Indemnities* arbitration, for example, Turkey invoked *force majeure* and argued that it was not able to repay Russia for certain loans due to both financial problems and domestic insurrections.⁴⁵ Although the tribunal acknowledged “international law must adapt itself to political necessities,”⁴⁶ it declined to accept Turkey’s plea because Turkey had been able to obtain loans and make other large payments during the relevant time.⁴⁷

Thereafter a similar plea—with a similar result—was presented in 1929 in the Brazilian loans case.⁴⁸ There, the primary question was whether Brazil was obligated to repay certain amounts to foreign bondholders in paper francs or gold francs, a question which acquired particular significance after paper francs suffered significant depreciation.⁴⁹ Brazil argued that it faced a situation of *force majeure* due to war that should annul, or at least suspend its obligations. The Permanent Court of International Justice, however, rejected this argument, reasoning that Brazil’s inability to pay in gold coins did not preclude payment in another form for the gold value.⁵⁰ Again, however, the tribunal did not reject the existence of the plea, but rather found that its requirements were not satisfied under the facts at issue.

45. As the tribunal stated:

Turkey was, from 1881 to 1902, in the midst of financial difficulties of the utmost seriousness, combined with domestic and foreign events (insurrections, wars) which forced it to make special disposition of a large part of its revenues, to submit to foreign control a part of its finances, to even grant a delay in payment to the Ottoman Bank, and, generally, it could satisfy its obligations only through delay and postponements, and even then at great sacrifice.

Russ. v. Turk., 11 R.I.A.A. 421 (1912).

46. *Id.*

47. The tribunal held that, due to Turkey’s ability to meet other financial obligations, “[i]t would clearly be exaggeration to allow that the payment (or the securing of a loan for the payment) of the comparatively small sum [at issue in that case] would imperil the existence of the Ottoman Empire or seriously compromise its internal or external situation.” *Id.*

48. Braz. v. Fr. 1929 P.C.I.J. (ser. C) No. 16, at 120 (May 27).

49. *Id.* at 95–96, 100. As the Permanent Court of International Justice (“PCIJ”) noted, the legal challenge was brought “after the increasing depreciation of the French franc, the service of the loan was effected in that currency on the basis of its current value, ultimately led to protests and the taking of steps by the bondholders with a view to inducing the French Government to intervene.” *Id.* at 100.

50. *Id.* at 122–23.

Other cases in which necessity was invoked to avoid international obligations follow a similar pattern.⁵¹ Thus, even before the ILC formulated its strict criteria for establishing a necessity plea in the Draft Articles, international tribunals generally declined to recognize financial hardship as permitting States to avoid international obligations. Though these tribunals did generally acknowledge the existence of such a plea, they construed it narrowly and simply found that it did not apply to the circumstances before them. Such a construction of the plea permits States only very limited flexibility of action in responding to emergency situations.

The cyclical economic trends that affect the burdens imposed on host States due to investment obligations, however, require reasonable flexibility in permitting States to respond to emergency situations, including financial emergencies. As demonstrated above, the customary international law plea of “necessity” is inadequate to balance States’ interests in legitimate regulation with protection of investors. Particularly in recent years, as economic volatility has increased, States have sought—and needed—additional flexibility in

51. For example, a similar plea was also made and rejected in the *Société Commerciale de Belgique*, 1939 P.C.I.J. (ser. C) No. 87 (June 15). Before that case was filed, Belgium had won an award of 6 million “gold dollars” against Greece based on Greece’s failure to pay as promised on certain bonds sold to Belgian holders to finance a Greek railway project. *Id.* at 166–67. When Greece failed to pay this award, Belgium brought a second arbitration. In this second proceeding, Greece acknowledged that the first award was binding, but argued that “by reason of its budgetary and monetary situation . . . it is materially impossible for the Greek Government to execute the awards as formulated” and requested that the Greek Government and the Belgian entity should “be left to come to some arrangement for the execution of these awards which will correspond with the budgetary and monetary capacity of the debtor.” *Id.* at 165. As in the previous arbitrations, Greece’s plea ultimately did not attract the tribunal’s support. Although the majority acknowledged that a settlement by the two governments regarding the dispute was “highly desirable,” the majority found that it lacked jurisdiction, based on the parties’ statements, to rule on Greece’s capacity to pay. *Id.* This rationale is unsatisfying and appears to be a rather obvious attempt to sidestep the relevant question. However, even if the tribunal had taken a broader view of its jurisdiction, the result would likely have been the same—and Greece’s debt would not have been forgiven—because even the judges filing separate opinions who would have reached this question did not necessarily agree with Greece’s argument. Judge Hudson stated that it was unnecessary to determine whether Greece had the capacity to pay the amount of the award from the previous arbitral decision because Belgium had clarified in its pleadings that it was not seeking a lump sum payment of that amount. *Id.* at 167. Moreover, Judge Hudson also thought that Greece had not proven its inability to pay the amounts awarded. *Id.* Judge Eysinga did not state whether he believed such a case had been made, but rather stated that such a determination was within the tribunal’s jurisdiction, despite the parties’ statements to the contrary. Judge Eysinga did note, however, that such a determination could be made only after receiving an expert report. *Id.* at 182.

maintaining their economic equilibrium. As discussed in the next section, the United States in particular has seen the need for BIT clauses that aim to achieve this balance. Despite recognizing the need for such provisions, however, the United States has failed to implement a coherent approach to exceptions clauses in its BITs.

II. EXCEPTIONS CLAUSES IN US TREATY PRACTICE

In light of the narrow scope of the necessity plea in customary international law, and indeed, the lingering doubts about the status and existence of any such plea, States seeking to preserve an exit from investment-treaty commitments have long done so with explicit provisions to that effect in their investment treaties.

The United States has been a part of this trend, including exceptions clauses even in its earliest BITs and continuing this practice today. In recent years, and particularly after the Argentina decisions, exceptions clauses in BITs have received greater attention from negotiators, including those in the United States. Thus, the United States—like other States—has expanded its use of exceptions clauses in recent treaties by including fact-specific exceptions as well as a catch-all exception.

As described below, the 2012 US Model BIT includes three separate exceptions clauses, one for matters of essential security, another for environmental measures, and a third for financial services.⁵² While US BITs have long included some form of the essential security exception, the environmental and financial services exceptions clauses are relatively new. In the following sections, these two new clauses are discussed first, followed by an extended discussion of the longstanding essential security exception.

A. *Financial Services Exceptions*

The lengthiest exceptions provision in the 2012 US Model BIT is the “Financial Services” provision, which actually includes two separate exceptions.⁵³ The exceptions in the “Financial Services” provision are exceedingly well-drafted and, as noted below, go a long way toward balancing investor protection and the host State’s freedom to respond to financial emergencies.

52. 2012 US Model BIT, *supra* note 7, at arts. 12, 18, 20.

53. *Id.* at art. 20.

1. Description

The first financial services exception permits the host State to take prudential actions related to financial services, particularly actions to ensure the integrity and stability of the State's financial system. As that exception states:

Notwithstanding any other provision of this Treaty, a Party shall not be prevented from adopting or maintaining measures relating to financial services for prudential reasons, including for the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial services supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of this Treaty, they shall not be used as a means of avoiding the Party's commitments or obligations under this Treaty.⁵⁴

“Prudential reasons” under this provision “include[] the maintenance of the safety, soundness, integrity, or financial responsibility of individual financial institutions, as well as the maintenance of the safety and financial and operational integrity of payment and clearing systems.”⁵⁵ The term “financial services” and this exception generally tracks similar usage in international trade law, and in US Free Trade Agreements, thus providing clarity to key terms and guidance on the proper interpretation of this provision.⁵⁶

In the same article, the 2012 US Model BIT includes a related exception that preserves the host State's freedom of action in monetary and related policies: “Nothing in this Treaty applies to non-discriminatory measures of general application taken by any public entity in pursuit of monetary and related credit policies or exchange rate policies.”⁵⁷ This monetary policy exception also “derives from”

54. *Id.* at art. 20.

55. *Id.* at n.18.

56. *Id.* at art. 20(7). The term “financial services” has the same definition as under paragraph 5(a) of the General Agreement on Trade in Services (“GATS”) Annex on Financial Services. The so-called “prudential exception” was taken verbatim from article 2(a) of the GATS Annex on Financial Services and recent US Free Trade Agreements (“FTAs”), the first of which was NAFTA. Caplan & Sharpe, *supra* note 5, at 817 n.255.

57. 2012 US Model BIT, *supra* note 7, at art. 20(2)(a).

international trade law,⁵⁸ thus providing a context to the likely application of this provision, despite its newness.⁵⁹

The “Financial Services” provision of the 2012 US Model BIT further provides procedural mechanisms that help ensure that arbitral tribunals responsibly and thoroughly consider pleas under this clause. The BIT provision sets out special procedures for choosing arbitrators with expertise in finance if a respondent indicates an intention to plead the “Financial Services” exceptions in response to a claim against it.⁶⁰ As the article states, “[i]n the appointment of all arbitrators not yet appointed to the tribunal, each disputing party shall take appropriate steps to ensure that the tribunal has expertise or experience in financial services law or practice.” This requirement of expertise applies also to the presiding arbitrator, and if the plea is raised after the presiding arbitrator has been appointed “such arbitrator shall be replaced at the request of either disputing party and the tribunal shall be reconstituted” to take into consideration the need for expertise to address the plea.⁶¹ Ensuring that the arbitrators have expertise in financial matters goes a long way towards balancing investment protection with preserving a State’s freedom to act in response to an emergency.⁶² Arbitrators with such a background will be better able to weigh the availability and relative effectiveness of States’ emergency measures, determine whether a claim of financial emergency has been manufactured, and are generally more likely to reach reasonable decisions on the proper responses to a financial emergency.

58. Caplan & Sharpe, *supra* note 5, at 818. The analogous trade-law provision is Article I(3)(b) of the GATS, which excepts “services supplied in the exercise of governmental authority” from the scope of the GATS.

59. The provision in the 2012 US Model BIT may be more limited than the analogous trade-law provision, however, because the BIT provision is limited to governmental measures in pursuit of monetary or exchange rate policies. Moreover, the provision specifically “do[es] not include measures that expressly nullify or amend contractual provisions that specify the currency of demonization or the rate of exchange of currencies” and the exception does not affect investment agreement obligations regarding transfers or performance requirements. 2012 US Model BIT, *supra* note 7, at art. 20(2)(a) n.19. Despite these limitations, the trade-law analogy provides guidance for the interpretation of such an article.

60. *Id.* In particular, the article seeks to ensure that the tribunal has sufficient expertise to address the plea effectively.

61. 2012 US Model BIT, *supra* note 7, at art. 20(3)(c)(ii).

62. A further improvement to the provision might be to require that arbitrators have expertise in assessment of investment risk, which would likely provide additional protection to investors’ interests.

The US Model BIT provision also permits States to take the decision out of the hands of arbitrators if the financial emergency provisions have been invoked. A State invoking the “Financial Services” provision must also request a joint determination by the financial authorities of both States party to the treaty as to the applicability of the that provision in the particular case.⁶³ If the relevant authorities jointly decide that the “Financial Services” provision has been properly invoked, this determination “shall be binding on the tribunal.”⁶⁴ This request procedure and its binding character allows States a valuable and powerful tool in the arbitration, even before the case begins in earnest. In particular, this request procedure essentially allows States themselves to decide the scope of the plea—albeit jointly—without resort to an arbitral panel, even a panel of financially savvy arbitrators.

Finally, the article also includes a provision, new in the 2012 Model BIT, which permits the Tribunal to decide, at the respondent’s request, the applicability of one of these exceptions “prior to deciding the merits of the claim.”⁶⁵ Provisions substantially similar to these appear in the US-Rwanda BIT.⁶⁶

2. Analysis

The “Financial Services” provision in the 2012 US Model BIT is exceedingly detailed and well-drafted for balancing States’ interests and investment protection in three particular respects. First, by requiring arbitrators to have expertise in financial matters, the financial services provision makes it more likely that a decision on the existence of a financial emergency will be well-considered and

63. Moreover, under the 2012 US Model BIT, it appears that the United States wanted to prevent tribunals from relying on non-agreement by the competent authorities in this provision as an indication that a challenged financial measure violated the treaty—a provision added after the 2004 US Model BIT states that “[t]he tribunal shall draw no inference regarding the application [of either financial services exception] from the fact that the competent financial authorities have not made [such a joint] determination.” *Id.* at art. 20(3)(c)(iii).

64. *Id.* at art. 20(3)(b).

65. *Id.* at art. 20(3)(e). Based on this change, and the change noted at note 63, it appears that the 2012 US Model BIT provides slightly more freedom of action to host States than the 2004 US Model BIT.

66. Treaty Between the Government of the United States of America and the Government of the Republic of Rwanda Concerning the Encouragement and Reciprocal Protection of Investment art. 20, US-Rwanda, Feb. 19, 2008, T.I.A.S. 12101 [hereinafter US-Rwanda BIT].

logical, rather than simply relying on a comparative perspective of other financial crises.

Second, by permitting States to agree on whether the “Financial Services” provision has been properly invoked and by making such an agreement binding on an arbitral tribunal, this provision empowers States party to the BIT to essentially negate the decision of an investor to bring a claim. For the investor’s home State, this provision resembles an anti-espousal provision by allowing the investor’s home State to overrule the individual investor’s choice to bring an arbitral claim against a treaty partner. In the traditional espousal context, by contrast, the State chooses whether to bring the claim of its citizen before an international tribunal.

Finally, by allowing arbitral tribunals to consider the “Financial Services” provision as a preliminary matter, and particularly by requiring such a preliminary decision if the respondent State requests, this provision goes a long way to discourage frivolous claims by investors and offers significant protection to respondent States in the form of potentially saved legal costs. Thus, the “Financial Services” provision in the 2012 US Model BIT reflects detailed consideration and address States’ concerns in the context of invoking a necessity plea to avoid obligations in an investment treaty, while still offering credible and real protection to investment. Such detailed consideration is less evident, however, in the other two exceptions in the 2012 US Model BIT.

B. Environmental Exception

The second exceptions clause in the 2012 US Model BIT is part of a provision called “Investment and Environment,” which appears intended to provide particular leeway for States to enact laws that protect the environment. As discussed in Section 2 below, however, the “Investment and Environment” provision leaves much to be desired in terms of clarity and balance.

1. Description

The “Investment and Environment” provision in the 2012 US Model BIT states generally that “it is inappropriate to encourage investment by weakening or reducing the protections afforded in domestic environmental laws” and guarantees regulatory freedom

with respect to environmental matters.⁶⁷ US officials have written—in an unofficial capacity—that this provision generally “reflect[s] the policy goal of avoiding a ‘race to the bottom,’ where foreign investment is pursued at the expense of the environment.”⁶⁸

The “Investment and Environment” provision also contains language that could be construed as an exception to investment protections for environmental measures. This language provides, “[n]othing in this Treaty shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.”⁶⁹

This language has been characterized as part of the “definitions and interpretive statements that define the scope of the Parties’ obligations” with respect to investment and environment.⁷⁰

A similar provision was included the 2004 US Model BIT, but the provision in the 2012 US Model BIT strengthened the protections of the 2004 provision.⁷¹ Thereafter, this “Investment and Environment” provision—including its apparent exceptions clause—appeared in the most recent US BIT with Rwanda, which was signed in 2008 and entered into force in 2012.⁷² The provision has not yet been interpreted by arbitral tribunals.

2. Analysis

Ensuring that investment treaties are consistent with environmental standards is an admirable goal. Indeed, both developed

67. 2012 US Model BIT, *supra* note 7, at art. 12(2).

68. Caplan & Sharpe, *supra* note 5, at 805.

69. 2012 US Model BIT, *supra* note 7, at art. 12. Article 12 also provides an opportunity for a party to request consultations regarding matters arising under the Article, a provision that is generally used in concert with other transparency and public participation provisions in the US Model BIT, such as Articles 10 and 11.

70. Caplan & Sharpe, *supra* note 5, at 806.

71. *Id.* The 2012 US Model BIT added a general provision that “[t]he parties recognize that their respective environmental laws and policies, and multilateral environmental agreements to which they are both party, play an important role in protecting the environment.” 2012 US Model BIT, *supra* note 7, at art. 12(1). The 2012 Model BIT also states that “each party shall *ensure* that it does not waive or otherwise derogate from” these provisions, *id.* at art. 12(2) (emphasis added), whereas the 2004 US Model BIT only required that the treaty parties would “strive to ensure” this goal, 2004 US Model BIT art. 12(1), available at <http://www.state.gov/documents/organization/117601.pdf>.

72. US-Rwanda BIT, *supra* note 66, at art. 12.

and developing States—despite frequent disagreements on other aspects of investment law—appear to agree on the importance of such provisions in investment treaties.⁷³ The ambiguities in the “Investment and Environment” provision of the 2012 US Model BIT, however, render that particular provision unsatisfactory in achieving this goal.

First, the provision does not provide guidance on what consequences might follow from a State’s decision to undertake a measure that falls within the scope of this provision. Is that measure “justified” so that no wrong is committed, or has the State still committed a wrong, but this wrong is merely excused by this section? A third possibility also exists—should a measure’s relationship to environmental protection be considered in the calculation of damages resulting from that measure, and accordingly reduce the damages awarded? The 2012 US Model BIT provides no answers to these questions, thus leaving them to the discretion of a potential future arbitral tribunal.

Second, what latitude does the United States—or its treaty partners—have in determining what environmental measures “it considers” appropriate? As discussed below, the self-judging nature of exceptions to obligations under international law raised much concern during the drafting of the ILC Draft Articles. Despite this concern over self-judging language, it is unclear what latitude the inclusion of such language might provide in addition to the latitude provided by the existence of the exception. The inclusion of this language therefore appears likely to cause concern with US treaty partners and potential treaty partners, and—even if ultimately included in the treaty—will not greatly benefit the United States.

Third, what is the difference between an “appropriate” measure, a “necessary” measure, and—as in the ILC Draft Articles’ necessity provision—a measure that is the “only way” to achieve a certain

73. And indeed, both developed and developing countries have raised concerns that investment treaties have led to decreases in their environmental protection standards. See Stuart G. Gross, Note, *Inordinate Chill: BITs, Non-NAFTA MITs, and Host-State Regulatory Freedom—An Indonesia Case Study*, 24 MICH. J. INT’L L. 893 (2003); Katie Zaunbrecher, Note, *Pac Rim Cayman v. Republic of El Salvador: Confronting Free Trade’s Chilling Effect on Environmental Progress in Latin America*, 33 HOUS. J. INT’L L. 489, 501–02 (2011) (describing one multi-national’s arbitral case against El Salvador and suggesting that “[i]nternational tribunals cannot force a government to repeal [environmental and public safety regulations] but the potential for massive arbitral awards often produces a chilling effect on responsible policy-making”).

goal? The use of the loosely-defined word “appropriate,” when combined with self-judging nature of the “it considers” language, would appear to grant a State such wide latitude that any measure even vaguely related to the environment could enjoy protection under this provision. Such a result is hardly desirable in a treaty that, at its core, seeks to protect investment.

Finally, how could the treaty be “construed to prevent” a party from adopting a measure that is “otherwise consistent with this treaty”? If a measure is consistent with the treaty, it cannot be construed otherwise, can it? The first phrase, which states that the treaty shall not be construed to prevent certain laws, indicates that the clause was intended to exempt certain domestic environmental laws from application of the treaty norms—that is, if a measure intended to protect the environment would otherwise violate the guarantee of “fair and equitable” treatment, this provision will preserve that provision. The inclusion of the second phrase, “otherwise consistent with this treaty,” however, indicates that such an environmental measure would not be protected under this provision—if the measure violates the fair and equitable treatment standard, it is not otherwise consistent with the treaty, and therefore cannot enjoy protection under this clause. This contradiction in phrases appears to defeat the entire clause.

As the foregoing demonstrates, the ambiguous terms of the “Investment and Environment” provision of the 2012 US Model BIT leave much to the discretion of tribunals. Given such broad discretion, as the Argentina cases demonstrate, arbitral tribunals may reach undesirable, conflicting, or illogical decisions on these matters, increasing uncertainty for both investors and States and potentially leading to disastrous awards. Unfortunately, similar flaws appear in the “Essential Security” provision, also potentially leading to an unpredictable decision by an arbitral tribunal and a large award against a State party.

C. Essential Security Exception

The oldest and most general of the exceptions clauses in the 2012 US Model BIT is the “Essential Security” provision. This provision contains broader language than the other two exceptions and therefore, particularly after the recent addition of the fact-specific “Investment and Environment” and “Financial Services” clauses, may be construed to serve as a catch-all exception clause. The “Essential

Security” provision of US BITs has evolved significantly in recent years. Among other developments, discussed more fully below, the provision is now explicitly self-judging in both the treaty and the US letter of transmittal, and the term “essential security” is left largely undefined.

1. Description

The essential security clause in the 2012 US Model BIT, like the “Investment and Environment” provision, contains explicitly self-judging language. Also like the “Investment and Environment” provision the “Essential Security” provision does not provide clear definitions of relevant terms, such as what might be deemed an essential security interest, and what consequences might follow from measures that fall within this provision. The “Essential Security” provision of the 2012 U.S. Model BIT provides, “[n]othing in this this Treaty shall be construed: . . . 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.”⁷⁴

Although this version of the essential security clause was included in the US Model BIT for the first time in 2004, it was actually developed earlier as part of a previous unpublished update to the 1994 US Model BIT.⁷⁵ Accordingly this version of the essential security clause is included in several recent investment agreements, namely the US BITs with Bahrain,⁷⁶ Mozambique,⁷⁷ Uruguay,⁷⁸ and

74. 2012 US Model BIT, *supra* note 7, at art. 18.

75. Kenneth Vandeveld writes that this self-judging language in the treaty provision was part of a 1998 revision to the 1994 model treaty—apparently part of a general 1998 revision that was not treated publicly as resulting in a new model. Kenneth J. Vandeveld, *A Comparison of the 2004 and 1994 US Model BITs: Rebalancing Investor and Host State Interests*, in YEARBOOK ON INTERNATIONAL INVESTMENT LAW AND POLICY 283 (Karl P. Sauvant, ed., 2009).

76. Treaty Between the Government of the United States of America and the Government of the State of Bahrain Concerning the Encouragement and Reciprocal Protection of Investment, US-Bahr., Sept. 29, 1999, T.I.A.S. 13065.

77. Treaty Between The United States of America and The Republic of Mozambique Concerning the Encouragement and Reciprocal Protection of Investment, US-Mozam., Dec. 1, 1998, T.I.A.S. 13006.

78. Presidential Letter of Transmittal for the Uruguay Bilateral Investment Treaty art. XVIII (Nov. 4, 2005) available at http://www.sice.oas.org/Investment/BITSbyCountry/BITS/URU_US_e.asp

Rwanda.⁷⁹ Similar clauses appear in US treaties outside the BIT context, such as the US-Panama Free Trade Agreement.⁸⁰

This “Essential Security” provision has also warranted particular attention in the letters of transmittal that the Executive Branch provides to Congress when requesting the ratification of a BIT. For the US-Bahrain BIT, for example, the letter of transmittal confirms the self-judging nature of the clause, and seeks to add substance to the terms “international peace and security” and “essential security interest.” As that letter provides:

[The “Essential Security” provision] reserves the right of a Party to take measures that it considers necessary for the fulfillment of its international obligations with respect to maintenance or restoration of international peace or security, as well as those measures it regards as necessary for the protection of its own essential security interests. International obligations with respect to maintenance or restoration of peace or security would include, for example, obligations arising out of Chapter VII of the United Nations Charter. Measures permitted by the provision on the protection of a Party’s essential security interests would include security-related actions taken in time of war or national emergency. Actions not arising from a state of war or national emergency must have a clear and direct relationship to the essential security interests of the Party involved. This Treaty makes explicit the implicit understanding that measures to protect a Party’s essential security interests are self-judging in nature, although each Party would expect the provisions to be applied by the other in good faith.⁸¹

This language in the letter of transmittal gives a broad and somewhat circular definition to the term “essential security interests”—the letter defines that term to include not only actions taken in war or national emergency but also other security-related

79. U.S.-Rwanda BIT, *supra* note 66.

80. US-Panama FTA art 21.2 provides that
Nothing in this Agreement shall be construed:

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.

A footnote to this provision states that: “[f]or greater certainty, if a Party invokes Article 21.2 in an arbitral proceeding initiated under Chapter Ten (Investment) or Chapter Twenty (Dispute Settlement), the tribunal or panel hearing the matter shall find that the exception applies.” US-Panama Free Trade Agreement, US-Pan, Jun. 28, 2007.

81. Presidential Letter of Transmittal for the Bahrain Bilateral Investment Treaty, *available at* <http://www.state.gov/documents/organization/43479.pdf>.

actions that have “a clear and direct relationship to the security interests of the party involved. Under this definition, then, an essential security interest is an interest that relates to security. Such a broad and circular interpretation of the clause, combined with the self-judging nature of the clause—although apparently subject to a good faith test—could be seen to create an exceedingly broad exception to investment treaty protections.

This provision was not always so broad, however, and the language of this essential security clause has evolved significantly since early US investment treaties. The self-judging language “it considers” was absent in the early versions of this clause, and the provision applied to measures aimed at both “the maintenance of public order and public morals” as well as “essential security interests.” These early BIT provisions are based on the 1984 US Model BIT, which provided, “This Treaty shall not preclude the application by either Party of measures necessary in its jurisdiction 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.”⁸²

Clauses of this type—without the self-judging language and with the reference to “public order”—are included in the US BITs with Grenada,⁸³ Bangladesh,⁸⁴ Sri Lanka,⁸⁵ Kyrgyzstan,⁸⁶ Turkey,⁸⁷ Panama,⁸⁸ Czech Republic,⁸⁹ Tunisia,⁹⁰ and Argentina.⁹¹

82. US Model Treaty Concerning the Reciprocal Encouragement and Protection of Investment art. X, Feb. 24, 1984, *reprinted in* 4 INT'L TAX & BUS. LAW. 136, 142 (1986).

83. Presidential Letter of Transmittal for the Grenada Bilateral Investment Treaty art. X, May 2, 1986, *available at* <http://www.state.gov/documents/organization/43562.pdf>.

84. Presidential Letter of Transmittal for the Bangladesh Bilateral Investment Treaty art. X, Mar. 12, 1986, *available at* <http://www.state.gov/documents/organization/43480.pdf>.

85. Presidential Letter of Transmittal for the Sri Lanka Bilateral Investment Treaty art. X, Nov. 20, 1991, *available at* <http://www.state.gov/e/eb/afd/43361.htm>.

86. Presidential Letter of Transmittal for the Kyrgyzstan Bilateral Investment Treaty art. X, Jan. 19, 1993, *available at* http://tcc.export.gov/Trade_Agreements/All_Trade_Agreements/exp_005704.asp.

87. Presidential Letter of Transmittal for the Turkey Bilateral Investment Treaty art. X, Dec. 3, 1985, *available at* http://www.sice.oas.org/Investment/BITSbyCountry/BITS/US_Turkey_e.asp.

88. Presidential Letter of Transmittal for the Panama Bilateral Investment Treaty art. X, Oct. 27, 1982, *available at* <http://www.state.gov/e/eb/afd/43310.htm>.

89. Presidential Letter of Transmittal for the Czech Republic Bilateral Investment Treaty art. X, Oct. 22, 1991, *available at* <http://www.state.gov/documents/organization/43557.pdf>.

90. Presidential Letter of Transmittal for the Tunisia Bilateral Investment Treaty art. X, May 15, 1990, *available at* <http://www.state.gov/e/eb/afd/43364.htm>.

Other treaties of that time use this language, with the addition of a reference to “public morals” or “morality.” For example, the US-Congo BIT, which was signed in 1983 and entered into force in 1989, contains the following provision:

This Treaty shall not preclude the application by either Party of measures necessary in its territory for the maintenance of *public order and morality*, the fulfillment of its obligations with respect to the maintenance and restoration of international peace and security, or the protection of its own essential security interests.⁹²

A clause with substantially the same language, and substantially the same explanation in the Letter of Submittal, appears in the US BITs with Senegal,⁹³ Cameroon,⁹⁴ Morocco,⁹⁵ and—with an additional clause—Egypt.⁹⁶

The letters of transmittal for these early treaties provide little guidance on what might constitute “public order” or “public order and morality,” but rather simply state that “this clause declares that the treaty shall not preclude measures necessary for public order or essential security interests.”⁹⁷ In later treaties, the language of the “Essential Security” provision remained the same, but the letter of transmittal provided more detail. The letter of transmittal for the US-Kazakhstan BIT, for example, which was signed in 1992 and entered

91. Presidential Letter of Transmittal for the Argentina Bilateral Investment Treaty art. X, Nov. 14, 1991, *available at* http://tcc.export.gov/trade_agreements/all_trade_agreements/exp_000897.asp.

92. Presidential Letter of Transmittal for the Congo Bilateral Investment Treaty art. X, Aug. 3, 1984, *available at* <http://www.state.gov/documents/organization/43544.pdf>.

93. Presidential Letter of Transmittal for the Senegal Bilateral Investment Treaty art. X, Dec. 6, 1983, *available at* <http://www.state.gov/documents/organization/43585.pdf>.

94. Presidential Letter of Transmittal for the Cameroon Bilateral Investment Treaty art. X, Feb. 26, 1986, *available at* <http://www.state.gov/e/eb/afd/43244.htm>.

95. Presidential Letter of Transmittal for the Morocco Bilateral Investment Treaty art. X, July 22, 1985, *available at* <http://www.state.gov/documents/organization/43580.pdf>.

96. Presidential Letter of Transmittal for the Egypt Bilateral Investment Treaty art. X, Mar. 11, 1986, *available at* <http://www.state.gov/documents/organization/43559.pdf>. Article X provides in relevant part:

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.

This last clause, which permits “measures deemed appropriate by the Parties” to fulfill future international obligations” appears unique in US BITs, and the meaning of this provision is not revealed in the letter of transmittal or other documents.

97. Presidential Letter of Transmittal for the Congo Bilateral Investment Treaty art. X, Aug. 3, 1984, *available at* <http://www.state.gov/documents/organization/43544.pdf>.

into force in 1994, gives meaning to the terms public order, obligations with respect to peace and security, and essential security:

The maintenance of public order would include measures taken pursuant to a Party's police powers to ensure public health and safety. International obligations with respect to peace and security would include, for example, obligations arising out of Chapter VII of the United Nations Charter. Measures permitted by the provision on the protection of a Party's essential security interests would include security-related actions taken in time of war or national emergency; actions not arising from a state of war or national emergency must have a clear and direct relationship to the essential security interest of the Party involved.⁹⁸

Indeed, the language included in this early letter of transmittal is still included in the letters of transmittal for the most recent current BITs.

Further, although the treaty provision itself is the same as in the 1984 Model BIT, except for the self-judging language, the letter of transmittal states that clause is self-judging: measures it regards as necessary for the maintenance of public order, the fulfillment of its international obligations with respect to international peace and security, or measures *which it regards as necessary* for the protection of its own essential security interests.⁹⁹

Thus, it appears that the United States came to view this language as self-judging, or at least wished that the language would be so viewed by others, sometime after 1994. The same combination of treaty language and letter-of-transmittal language appears in US BITs that entered into force in 1994 or thereafter¹⁰⁰—specifically, in

98. Presidential Letter of Transmittal for the Kazakhstan Bilateral Investment Treaty art. X, May 19, 1992, *available at* <http://www.state.gov/documents/organization/43566.pdf>. The treaty provision in question provides, “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.”

99. *Id.*

100. The transition was not completely smooth because the US BITs with Romania and Poland, both of which entered into force in 1994, retain the previous (non-self-judging) letter of transmittal.

the US BITs with Moldova,¹⁰¹ Armenia,¹⁰² Latvia,¹⁰³ Ukraine,¹⁰⁴ Jamaica,¹⁰⁵ Ecuador,¹⁰⁶ Estonia,¹⁰⁷ and Mongolia.¹⁰⁸

Later, letters of transmittal acquired the additional sentence that we see in the US-Bahrain treaty quoted above—with a double reference to self-judgment, but the assurance that “each Party would expect the provisions to be applied by the other in good faith.” A similar combination of the language in the letter of transmittal and the treaty appears in the US BITs with Trinidad & Tobago,¹⁰⁹ Georgia,¹¹⁰ Albania,¹¹¹ Azerbaijan,¹¹² Bolivia,¹¹³ Honduras,¹¹⁴ Jordan,¹¹⁵ and Lithuania.¹¹⁶ Even in these mid 1990s treaties, however, with this double reference to self-judgment in the letter of transmittal, the treaty provision itself still contained no reference to self-judgment. The only significant change from the 1984 Model BIT provision

101. Presidential Letter of Transmittal for the Moldova Bilateral Investment Treaty art. IX, Sept. 7, 1993, *available at* http://tcc.export.gov/Trade_Agreements/All_Trade_Agreements/exp_005862.asp.

102. Presidential Letter of Transmittal for the Armenia Bilateral Investment Treaty art. X, Sept. 23, 1992, *available at* <http://www.state.gov/documents/organization/43477.pdf>.

103. Presidential Letter of Transmittal for the Latvia Bilateral Investment Treaty art. IX, Jan. 13, 1995, *available at* <http://www.state.gov/documents/organization/43568.pdf>.

104. Presidential Letter of Transmittal for the Ukraine Bilateral Investment Treaty art. IX, Mar. 4, 1994, *available at* http://tcc.export.gov/Trade_Agreements/All_Trade_Agreements/exp_005484.asp.

105. Presidential Letter of Transmittal for the Jamaica Bilateral Investment Treaty art. X, Feb. 4, 1994, *available at* <http://www.state.gov/e/eb/ifd/43289.htm>.

106. Presidential Letter of Transmittal for the Ecuador Bilateral Investment Treaty art. IX, Aug. 27, 1993, *available at* <http://www.state.gov/documents/organization/43558.pdf>.

107. Presidential Letter of Transmittal for the Estonia Bilateral Investment Treaty art. IX, Apr. 19, 1994, *available at* <http://www.state.gov/documents/organization/43560.pdf>.

108. Presidential Letter of Transmittal for the Mongolia Bilateral Investment Treaty art. X, Oct. 6, 1994, *available at* <http://www.state.gov/documents/organization/43579.pdf>.

109. Presidential Letter of Transmittal for the Trinidad & Tobago Bilateral Investment Treaty art. XIV, Sept. 26, 1994, *available at* <http://www.state.gov/e/eb/ifd/43363.htm>.

110. Presidential Letter of Transmittal for the Georgia Bilateral Investment Treaty art. XIV, Mar. 7, 1994, *available at* <http://www.state.gov/documents/organization/43561.pdf>.

111. Presidential Letter of Transmittal for the Albania Bilateral Investment Treaty art. XIV, Jan. 11, 1995, *available at* <http://www.state.gov/documents/organization/43474.pdf>.

112. Presidential Letter of Transmittal for the Azerbaijan Bilateral Investment Treaty art. XIV, Aug. 1, 1997, *available at* <http://www.state.gov/e/eb/ifd/43235.htm>.

113. Presidential Letter of Transmittal for the Bolivia Bilateral Investment Treaty art. XIV, Apr. 17, 1998, *available at* <http://www.state.gov/documents/organization/43541.pdf>. This BIT is now terminated.

114. Presidential Letter of Transmittal for the Honduras Bilateral Investment Treaty art. XIV, July 1, 1995, *available at* <http://www.state.gov/e/eb/ifd/43264.htm>.

115. Presidential Letter of Transmittal for the Jordan Bilateral Investment Treaty art. XIV, July 2, 1997, *available at* <http://www.state.gov/documents/organization/43565.pdf>.

116. S. TREATY DOC. No. 106–42 art. IX (1998), *available at* 1998 WL 1788085.

quoted above was the omission of the reference to “public order.” Only in very recent BITs was the language of the treaty itself changed.

The purposes of adding this self-judging language to the “Essential Security” provision included preserving greater regulatory discretion of the host State with respect to investment and circumscribing the discretion of arbitral tribunals, should a State’s regulation be challenged.¹¹⁷ According to one former US government official, the self-judging language in the treaty means that “a [S]tate has sole discretion to determine whether a measure it has adopted falls within the exception.”¹¹⁸ Current US officials take the same position regarding the same language the 2012 Model BIT, stating “[t]he phrase ‘it considers’ clarifies the intent of the Parties: the determination of what is necessary for the fulfillment of its obligations with respect to the maintenance and restoration of international peace and security and the protection of its essential security interests is within the discretion of that party.”¹¹⁹

2. Analysis

The current version of the “Essential Security” provision in US BITs has three major problems. First, like the “Investment and Environment” provision, the “Essential Security” provision leaves key terms undefined. The treaty does not reveal what might constitute an “essential security” interest, and even the letter of transmittal defines this term in a circular fashion. If this provision is invoked, arbitral tribunals will be left to use their discretion to determine what might constitute an essential security interest.

In addition, and also like the “Investment and Environment” provision, the inclusion of the self-judging “it considers” language likely does nothing to preserve freedom of action for the respondent State. As discussed below, however, such language has caused concern in the international community and is not likely to prove popular with investors. Thus, attempts to invoke this clause and its

117. Vandevelde, *supra* note 75, at 283. Vandevelde is careful to note, however, that the 2004 model is not weaker than the 1994 model in its protection of investment—instead the 2004 treaty involves “both the enhancement of host country regulatory discretion and an expansion of host country obligations.” *Id.*

118. *Id.* at n.49.

119. Caplan & Sharpe, *supra* note 5, at 813.

self-judging nature may be criticized, and arbitral tribunals may simply read that language narrowly in light of this larger concern.

Finally, the essential security clause, like the “Investment and Environment” provision, does not identify what consequences flow from conduct that falls within the “Essential Security” provision. Is such conduct excused, or justified, or does the presence of an essential security interest mean that the conduct reduces damages? Stability and predictability is of fundamental importance to both States and investors—indeed ensuring stability of legal rules has always been a principle reason behind the conclusion of BITs—but this purpose is undermined by such wildcard language as in this self-judging exception clause.

D. Conclusions with Respect to Exceptions in US BITs

As discussed above, the exceptions clauses in the 2012 US Model BIT, other than the financial security exceptions, are unsatisfactory in the goal of providing a clear balance between investment protection and host-State regulatory authority. A general problem with the “Investment and Environment” and “Essential Security” clauses is their self-judging language, which as discussed below, is a clumsy way of attempting to retain freedom of action for the host State and may not even succeed in achieving this goal. In addition, US BIT negotiators should clarify the relationship of these various exceptions clauses as between each other to clarify the scope of the host State’s freedom of action with respect to each type of exception.

1. Problems with Self-Judging Language

As noted above, it is unclear what consequences flow from the self-judging nature of the “Investment and Environment” and “Essential Security” provisions of the 2012 US Model BIT. Does the phrase “it considers” have the same meaning with respect to measures taken to “ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns” as well as measures for the “protection of [the host State’s] own essential security interests”? What is the significance of the absence of the phrase “it considers” in the “Financial Services” provision, particularly in light of that provision’s requirement of consultation between the finance ministries of the relevant States if the exception is to be invoked in an

arbitration? A logical position may be that the “it considers” language has been omitted from the “Financial Services” provision because the host State may obtain an official joint determination that the measures in question fall within the exception. The absence of any explanation for the inconsistent use of self-judging language, however, renders even the “Financial Services” provision unclear.

A second problem with the self-judging language is that there is no definitive interpretation of self-judging clauses in international law, and therefore neither the United States nor its investors can be sure how such a clause would be interpreted or applied in a given investment dispute. Moreover, there does not seem to be a significant difference between self-judging and non-self judging provisions in international law.¹²⁰ The International Court of Justice (“ICJ”) considered similar self-judging language in an information-sharing agreement in the *Case Concerning Certain Questions of Mutual Assistance in Criminal Matters (Djibouti v. France)*.¹²¹ The ICJ held that, although a self-judging clause grants a State “very considerable discretion[,] this exercise of discretion is still subject to the obligation of good faith codified in Article 26 of the 1969 Vienna Convention on the Law of Treaties.”¹²² Thus, the ICJ concluded that it had authority to examine whether the State had taken the action in question for reasons permitted under the self-judging clause.¹²³

120. Necessity provisions that are not explicitly self-judging have been interpreted narrowly. As the International Court of Justice has stated, “whether a given measure is ‘necessary’ is ‘not purely a question for the subjective judgment of the party’ and may thus be assessed by the Court.” *Oil Platforms (Iran v. US)*, Judgment, 2003 I.C.J. 161, ¶ 43 (Nov. 6) (quoting *Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. US)*, Judgment, 1986 I.C.J. 141, ¶ 282 (June 27)).

121. In that case, the clause concerned the obligation to provide assistance in criminal matters and provided that, as an exception to the general obligation to provide such assistance, “the requested State may refuse a request for mutual assistance if it considers that execution of the request is likely to prejudice [the] sovereignty, . . . security, . . . *ordre public* or other . . . essential interests [of the State from which information is requested].” 2008 I.C.J. 179, ¶ 28 (June 4) (quoting the French court’s decision on the matter).

122. *Djibouti*, 2008 I.C.J. ¶ 145. Article 26 states that “[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith.” Vienna Convention on the Law of Treaties art. 26, May 23, 1969, 1155 U.N.T.S. 331.

123. *Djibouti*, 2008 I.C.J. ¶ 145. Good faith review, according to Judge Keith’s separate opinion, may also require States “to exercise the power [in question] for the purposes for which it was conferred and without regard to improper purposes or irrelevant factors.” *See id.* at 279 ¶ 6 (declaration of Judge Keith); *see also* Stephan Schill & Robyn Briese, “*If the State Considers*”: *Self-Judging Clauses in International Dispute Settlement*, 13 MAX PLANCK Y.B. U.N. L. 61, 140 (2009) (“suggest[ing] that international Courts and Tribunals should adopt, similar to the position taken by Judge Keith in his Declaration in *Djibouti v. France*, an

State practice related to the security exception in the General Agreement on Tariffs and Trade also indicates that self-judging clauses are subject to good-faith review to ensure the clauses are invoked for intended purposes only.¹²⁴ And indeed, even the arbitral panel that decided the *LG&E v. Argentina* dispute—which was relatively sympathetic toward Argentina’s arguments based on the essential security clause of the US-Argentina BIT—found no discernable difference between a self-judging and a non-self-judging clause. The tribunal concluded that the provision was not self-judging, but stated that, “[w]ere the Tribunal to conclude that the provision is self-judging, Argentina’s determination would be subject to a good faith review anyway, which does not significantly differ from the substantive analysis presented here.”¹²⁵ Although there is some room for debate on the matter, the general consensus seems to be that self-judging clauses provide little, if any, additional freedom of action to the State.¹²⁶

approach that focuses on the characteristic element of self-judging clauses, namely the discretion accorded to States to favor domestic over international interests, by drawing on the grounds of judicial review for misuse of discretion under domestic administrative law systems.”). US government officials—writing in their personal capacity—have acknowledged this general interpretation of self-judging clauses, and specifically the ICJ’s *Djibouti v. France* judgment in commentary on the 2012 US Model BIT. As these officials have stated, the Court acknowledged that France had “very considerable discretion” and that “the Court conducted a very light review of the basis for France’s decision.” Caplan & Sharpe, *supra* note 5, at 755, 814 n.251 (quoting *Djibouti*, 2008 I.C.J. ¶ 145). The authors state that they are “not aware of any investor-State arbitral tribunal that has directly analysed the operation of a self-judging essential security provision.” *Id.*

124. See Alford, *supra* note 11, at 706–25. A General Agreement on Tariffs and Trade (“GATT”) Panel has considered the matter in the context of US sanctions against Nicaragua and issued a report that, although not binding, encourages states to weigh competing interests when invoking a self-judging security clause, and noting that an entirely self-judging security clause could be invoked “excessively of or for purposes other than those set out.” Report of the Panel, *United States-Trade Measures Affecting Nicaragua*, ¶¶ 5.1–5.18, L/6053 (Oct. 13, 1986), available at <http://www.worldtradelaw.net/reports/gattpanels/nicembargo.pdf>.

125. *LG&E Award*, *supra* note 13, ¶¶ 212–14. In this good faith review, the Tribunal concluded that the measures Argentina adopted were “a necessary and legitimate measure” because “[u]nder the conditions the Government faced . . . time was of the essence in crafting a response.” *Id.* ¶ 240.

126. One commentator has suggested that “[w]hile reviewability might seem to be the favoured interpretation . . . it is nevertheless possible that States might design necessity clauses that give complete deference to a State’s judgment that an emergency or necessity threatening the life of the nation exist. In this case, the extent of institutional review might be limited instead to the proportionality of measures taken during the situation of emergency or necessity.” Desierto, *supra* note 44, at 142. Such a proposition is illogical, however, because the existence of an essential security interest does not depend on the degree of action taken to preserve that interest.

Indeed, such a narrow reading of self-judging language in investment treaties may be appropriate because a broad reading of such clauses could defeat the entire investment regime. In fact, some commentators have taken this exact position with respect to investment treaties as a general matter:

A sweeping interpretation of necessity, as a self-judging doctrine causing the wholesale inapplicability of investment treaties, jeopardies the rules-based system and institutionalized dispute resolution processes inherent in the architecture of international investment obligations. Apart from creating the moral hazard of contracting States opting out of international obligations at their own instance (and disregarding the settled treaty modes of denunciation, suspension, or termination), this interpretation foments the threat of unbridled arbitrator discretion.¹²⁷

The same view has been expressed by a former US government official with respect to the 2012 US Model BIT in particular:

To my mind, the primary purpose of a BIT is to ensure that foreign investment is treated in accordance with the rule of law. For this reason, self-judging exceptions are especially troubling. A provision that exempts treaty provisions from the judicial or arbitral process is very difficult to reconcile with a treaty intended to establish the rule of law.¹²⁸

The potential for self-judgment also troubled members of the ILC in the discussions of the necessity provision of the ILC Draft Articles. As one committee member stated, “[t]here was always competition between the interests of the two States concerned; it might therefore be asked who was to decide which interest should prevail. If such a subjective criterion was retained, a State might be tempted to invoke the state of necessity abusively as a ground for preclusion of wrongfulness.”¹²⁹ In fact, the representative from the former Czechoslovakia found that a self-judging necessity plea could threaten the principle of sovereign equality.¹³⁰ In an equally serious

127. *Id.* at 211.

128. Kenneth Vandeveld, *Rebalancing through Exceptions*, 17 LEWIS & CLARK L. REV. 449, 458 (2013).

129. *Draft articles on State responsibility. Texts adopted by the Drafting Committee: articles 33 to 35 - reproduced in document A/CN.4/SR.1635, paras. 42, 53 and 62*, [1980] 1 Y.B. Int'l L. Comm'n 271, ¶ 48, U.N. Doc. A/CN.4/L.318.

130. *Comments and observations of Governments on part one of the Draft Articles on State responsibility for internationally wrongful acts*, [1983] 2(1) Y.B. Int'l L. Comm'n 2, U.N. Doc. A/CN.4/362. Czechoslovakia also objected to permitting a state to invoke a

condemnation, the UK representative, in 1998, stated that a State's ability to determine what interest it deems essential would not only be open to "very serious abuse across the whole range of international relations" but could also "weaken the rule of law."¹³¹

Indeed, there has long been suspicion of purportedly self-judging obligations in international law. Judge Higgins wrote that self-judging exceptions to acceptance of compulsory jurisdiction in the ICJ are "of doubtful legal status, because it is the Court that must determine its own jurisdiction."¹³² Judge Lauterpacht took a stronger view, arguing in his separate opinions to ICJ decisions that a self-judging reservation excepting some disputes from consent to the ICJ's jurisdiction was invalid, and that the State in question had therefore simply consented to ICJ jurisdiction without reservation because such consent was essential and could not be severed from the treaty.¹³³

necessity plea in circumstances other than the presence of an immediate threat to the existence of the State as a sovereign and independent entity. *Id.*

131. *Comments and observations received by Governments on State Responsibility*, [1998] 2(1) Y.B. Int'l L. Comm'n 134–35, U.N. Doc. A/CN.4/488.

132. ROSALYN HIGGINS, PROBLEMS & PROCESS 194 (1995).

133. As Judge Lauterpacht wrote in his separate opinion in *Certain Norwegian Loans (France v. Norway)*:

In accepting the jurisdiction of the Court Governments are free to limit its jurisdiction in a drastic manner. As a result there may be little left in the Acceptance which is subject to the jurisdiction of the Court. This the Governments, as trustees of the interests entrusted to them, are fully entitled to do. Their right to append reservations which are not inconsistent with the Statute is no longer in question. But the question whether that little that is left is or is not subject to the jurisdiction of the Court must be determined by the Court itself. Any conditions or reservations which purport to deprive the Court of that power are contrary to an express provision of the Statute and to the very notion, embodied in Article 36 (6), of conferment of obligatory jurisdiction upon the Court. As such they are invalid. It has been said that as Governments are free to accept or not to accept the Optional Clause, they are free to accept the very minimum of it. Obviously. But that very minimum must not be in violation of the Statute.

1957 I.C.J. 9, 46 (July 6); see also Roslyn Moloney, *Incompatible Reservations to Human Rights Treaties: Severability and the Problem of State Consent*, 5 MELB. J. INT'L L. 155, 159, 163–64 (2004) (discussing Lauterpacht's views and the three possible consequences of an invalid reservation to a treaty). Thus, one could argue that, if an investment treaty has a self-judging exceptions clause, then either the entire treaty is invalid, or the exceptions provisions are simply severed, and the State must offer full investment protections even in times of emergency, unless the requirements of necessity under customary international law are met. Such an argument could be bolstered with the argument that such a clause defeats the object and purpose of the treaty—protecting investment—because it permits a state to opt out of those protections at its own will, and indeed the clause is detrimental to the rule of law. See Vienna Convention on the Law of Treaties art. 19, *opened for signature* May 23, 1969, 1115 U.N.T.S. 331 (entered into force Jan 27, 1980) ("A State may, when signing, ratifying, accepting, approving or acceding to a treaty, formulate a reservation unless . . . the reservation is incompatible with the object and purpose of the treaty.") Under this logic, a tribunal

A counter-argument to the foregoing criticism of self-judging clauses may be that self-judgment in the investment-treaty context is appropriate because the competing interests in are inherently unequal. Under a State-centric concept of international law, a State's concerns for its own essential security or even environmental concerns would always outweigh the private interests of an individual investor. If this is the reason that the United States has included such language in its BITs, however, the United States should simply so explain in the terms of the treaty. The lack of such explanation permits the importation of general concerns in international law regarding self-judging language, and these concerns arise out of areas as diverse as consent to the ICJ's compulsory jurisdiction to the obligation to assist in criminal investigations. Clearly at least some of these concerns may not be applicable in the investment context, and the United States would be well-advised to clarify its use of that language.

Thus, the self-judging language in the "Investment and Environment" and "Essential Security" provisions of the 2012 US Model BIT, as currently drafted, likely gains the United States little or nothing in terms of freedom of action. The provision costs the United States a tremendous amount, however, in terms of credibility and reputation in its relations with investors, potential treaty partners, and the international community in general.

2. Failure to State Relationship Between Exceptions Provisions

A second fundamental problem with the exceptions provisions of the 2012 US Model BIT is that the model treaty provides no guidance on the relationship between these various exceptions provisions. Does the United States intend to preserve greater freedom of action for host States with respect to actions "necessary" to protect an essential security interest, than actions "appropriate" to protect the environment? Such a position would be rational, and as noted below, would be consistent with the approaches taken by other States in their model BITs and BITs in force. The US Model BIT provides no guidance on this question, however, because the "Investment and Environment," "Financial Services," and "Essential Security" provisions are contained in three separate, self-contained articles of

conceivably could declare the entire treaty invalid on the basis of an invalid exceptions clause, or perhaps simply could read that clause out of the treaty.

the treaty, and the treaty lacks any umbrella provision to govern all three.

Another unanswered question regarding the relationship between these provisions is whether an environmental or financial measure may fall within the “Essential Security” provision, despite the inclusion of the subject-matter-specific “Investment and Environment” and “Financial Services” provisions. That is, did the “Essential Security” provision ever apply to financial emergencies and environmental disasters, and did the United States intend to narrow the definition of an essential security interest in its BITs by including these subject-matter specific provisions? Such a position would be a departure from existing practice by international law. Even ILC representatives who were skeptical of other parts of the necessity provision of the ILC draft articles agreed that an environmental disaster could constitute an essential interest. As the UK representative stated, essential interests were “interests so essential that a breach of them threatens the economic or social stability of the State, or serious personal injury or environmental damage on a massive scale.”¹³⁴

Indeed this was precisely the holding of the ICJ in the *Gabčíkovo Nagymaros* case, and has been alluded to in other cases. There, the ICJ held that it had “no difficulty in acknowledging that the concerns expressed by Hungary for its natural environment . . . related to an ‘essential interest’ of that State” within the meaning of the then-current version of the ILC Draft Articles.¹³⁵ In *Gabčíkovo Nagymaros*, the ICJ also repeated a statement from its Advisory Opinion in the *Legality of the Threat of Nuclear Weapons*, that “the environment is not an abstraction but represents the living space, the quality of life and the very health of human beings, including generations unborn. The existence of the general obligation of States to ensure that activities within their jurisdiction and control respect the environment of other States or of areas beyond national control is now part of the corpus of international law relating to the

134. *Comments and observations received by Governments on State Responsibility*, [2001] 2(1) Y.B. Int'l L. Comm'n 56, U.N. Doc. A/CN.4/515. In fact, the United Kingdom took the position that necessity was “at the very edge of the rule of law” and that “it should not be included in a set of draft articles that describe the routine framework of legal responsibility between states.” *Id.*

135. *The Gabčíkovo-Nagymaros Project (Hung./Slovk.)*, 1997 I.C.J. 7, 41, ¶ 53 (Sept. 25).

environment.”¹³⁶ Indeed this concept was expanded into a duty to protect the environment in the *Pulp Mills* case, where the ICJ stated that “[a] [S]tate is . . . obliged to use all the means at its disposal in order to avoid activities which take place in its territory . . . causing significant damage to the environment of another State. This court has established that this obligation is ‘now part of the corpus of international law relating to the environment.’”¹³⁷ Thus, protection of the environment may arguably be an essential security interest, and the failure to define that the term in the 2012 US Model BIT leads to confusion, particularly in light of the inclusion of the “Investment and Environment” provision.

An additional problem in the relationship between the articles is presented by the differing verbs used therein. Under the “Investment and Environment” provision, the United States is not precluded from “adopting, maintaining, or enforcing” measures that fall within the clause. Under the “Essential Security” clause, by contrast, the United States is not precluded from “applying” a measure that falls within the clause. One reading of this difference in language may be that a State may “apply” existing measures to address matters of essential security, but it may not “adopt” additional measures to protect essential security interests, whereas it may adopt such measures to protect the environment. Indeed, this reading would be a significant limitation on the host State’s ability to protect its essential security interests, and would mean that the State has more freedom in responding to environmental concerns than essential security matters. An alternative reading is that the term “applying” encompasses the terms “adopting, maintaining, or enforcing” and includes an even broader swath of State action that would not necessarily follow the usual course of legislation. Such a reading is logical because the United States must have intended to preserve greater ability to react to a threatened “essential security” interest than in the area of environmental legislation, particularly because the “essential interest” category appears to include wars, insurrections, and similar actions. Although this second reading of the clause appears more logical than the first, the first reading remains plausible and thus could be adopted by an arbitral tribunal. If the United States intends to preserve greater

136. Legality of the Threat or Use of Nuclear Weapons, Advisory Opinion, 1996 I.C.J. 241-42, ¶ 29 (July 8).

137. *Pulp Mills on the River Uruguay* (Arg. v. Uru.), Judgment, 2010 I.C.J. 14, 56, ¶ 101 (Apr. 20).

freedom of action in the “Essential Security” provision—as the second reading would indicate—it should explicitly so state in the treaty. As the treaty stands, the matter is left to the discretion of arbitral tribunals.

There is an alternative to leaving such questions to arbitral tribunals, however. As discussed in the following section, other States have been creative in drafting their exceptions clauses, and have come up with various ways to preserve their freedom of action including reporting requirements and detailed provisions relating to the consequences of invoking these clause for both liability of the host State, and potential measures of damages. By incorporating some of these methods, the United States could improve the functioning and clarity of its BITs, while still protecting investments and preserving freedom of action of the host State in emergency situations.

III. *COMPARATIVE ANALYSIS OF BIT EXCEPTIONS*

As noted above, the United States is not the only State to recognize the need to protect its “essential security” or similar interests in its investment treaties. In fact, such an exceptions provision was included in the very first investment treaty, between Germany and Pakistan, concluded in 1959.¹³⁸ In that BIT, Pakistan reserved the right to deny investment protections for reasons of public security by appending the following statement to its acceptance of the treaty:

It is our understanding that, intending to facilitate and promote investments by German nationals or companies in Pakistan, the Government of Pakistan will, prior to the entry into force of an establishment treaty the negotiation of which has been provided for, grant necessary permits to German nationals who desire to enter, stay and carryon activities in Pakistan in connection with investments by German nationals or companies *except in so far as reasons of public security and order, public health or morality may warrant otherwise*.¹³⁹

Like Pakistan’s statement in its BIT with Germany, early model treaties and non-binding instruments also demonstrate that States

138. Treaty for the Promotion and Protection of Investments (with Protocol and exchange of notes), Ger.-Pak., November 25, 1959, 24 U.N.T.S. 6575.

139. *Id.* at n.V (emphasis added).

sought specific exceptions for cases of war, revolution, or similar situations. These traditional clauses are discussed in Section A below.

As discussed in Section B, States have recently begun refining this practice and including particularized exceptions clauses more frequently in their investment treaties. A comparison of these recent clauses to their predecessors reveals that States have begun to consider the circumstances under which they might seek to invoke an exception to investment-treaty protections, and States appear to seek to reserve such an exception not only for situations of armed conflict but also for a financial emergency or an environmental disaster, as the United States has done. As noted in this Section, this development in the exceptions clauses reflects States' evolving thinking in how to treat investment protections in times of emergency, and this comparative process offers guidance for the United States in its BIT negotiations with China and beyond.

A. Traditional Exceptions Clauses

Even the oldest BITs include clauses that permit exceptions to certain investment protections in times of war, generally requiring only treatment as favorable as domestic enterprises during such times. One such clause has long been included in the German model BIT, and still remains part of that treaty. The current iteration, which differs only slightly from the original provision, states:

Investors of either Contracting State whose investments suffer losses in the territory of the other Contracting State owing to war or other armed conflict, revolution, a state of national emergency, or revolt, shall be accorded treatment no less favourable by such other Contracting State than that State accords to its own investors as regards restitution, indemnification, compensation or other valuable consideration.¹⁴⁰

This provision, which essentially requires national treatment during situations of armed conflict, is echoed in the treaties of several other States.¹⁴¹ In fact, a similar provision appears in the 1959 Draft Convention on Investments Abroad, more commonly known as the Abs-Shawcross Convention, after its principle drafters Herman Abs,

140. Treaty between the Federal Republic of Germany and concerning the Encouragement and Reciprocal Protection of Investments art. 4, § 3, 2008, Federal Ministry for Economics and Technology.

141. *E.g.*, Netherlands Model Treaty art. 7.

of the Deutsche Bank, and Lord Shawcross, former UK Attorney General.¹⁴² As the Abs-Shawcross provision states:

No Party may take measures derogating from the present Convention unless it is involved in war, hostilities, or other public emergency, which threatens its life; and such measures shall be limited in extent and duration to those strictly required by the exigencies of the situation. Nothing in this Article shall be construed as superseding the generally accepted laws of war.¹⁴³

Other non-binding instruments of this time also foreshadowed future investment-treaty exceptions. Under the 1961 Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens, for example, treatment of alien property that would be otherwise wrongful could be justified based on “[t]he actual necessity of maintaining public order, health, or morality in accordance with laws enacted for that purpose” so long as those measures did not unreasonably depart from domestic law or principles of justice.¹⁴⁴

This provision—with its reference to public order and morality—rather obviously foreshadows the original version of the “Essential Security” provision in US BITs, and similar provisions in other States’ BITs. The important difference between this Harvard Draft Convention and the original US “Essential Security” clause, however, is the Harvard Draft Convention’s requirement that the measures do not unreasonably depart from domestic law or principles of justice. The inclusion of this language indicates that investments would still be protected to some degree even if measures were taken to achieve public order, health, or morality, and thus offers a clear balance between the interests of investors and those of States.

A guarantee of some protection was not included, however, in the “derogations” provision of the 1967 Organization for Economic Co-Operation and Development (“OECD”) Draft Convention on the Protection of Foreign Property:

A party may take measures in derogation of this Convention only if:

142. ANDREW NEWCOMB & LLUIS PARADELL, *LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT* 21–22 (2009).

143. Herman Abs & Lord Shawcross, *The Proposed Convention to Protect Foreign Investment: A Round Table Comment on the Draft Convention by its Authors*, 9 J. PUB. L. 116–17 (1960) (text of art. V).

144. Louis B. Sohn & R.R. Baxter, *Responsibility of States for Injuries to the Economic Interests of Aliens*, 55 AM. J. INT’L L. 545, 549 (1961).

(i) involved in war, hostilities or other grave public emergency of a nation-wide character due to force majeure or provoked by unforeseen circumstances or threatening its essential security interests; or

(ii) taken pursuant to decisions of the Security Council of the United Nations or to recommendations of the Security Council or General Assembly of the United Nations relating to the maintenance or restoration of international peace and security.

Any such measures shall be provisional in character and shall be limited in extent and duration to those strictly required by the exigencies of the situation.¹⁴⁵

Elements of the “Essential Security” provision in the US 2012 Model BIT are also clear in this provision of the OECD Draft Convention—in particular, the reference to UN Security Council actions and the maintenance of international peace and security.

Although these instruments are forward-thinking in their use of exceptions clauses, they do not set out a hierarchy of interests that allows more or less derogation from the investment treaty protections, depending on the gravity of the interest protected. Instead, these provisions differ among each other as to what protection, if any, might apply when an exceptions provision is invoked: Under the German Model Treaty, foreign investors can expect national treatment in a time of war; under the Harvard Draft Articles, they can expect to be treated within the provisions of national law and principles of justice; under the Abs-Shawcross and the OECD Draft Conventions, however, investors can expect no such protection.

As discussed in the next section, these early BIT practices and non-binding instruments have evolved into more complex and more deft treaty provisions, as States have realized the particular situations in which they might seek an exception to investment-treaty protections, and exactly the extent of any such exception. These newer treaties present a more sophisticated understanding of the relative interests that might warrant the invocation of an exceptions clause, and the variety in the consequences that might follow from the application of such a clause.

145. Organisation for Economic Co-operation and Development, Draft Convention on the Protection of Foreign Property art. 6, Oct. 12, 1967, 7 I.L.M. 117 (1968).

B. Recent Developments in Exceptions Clauses

Some States have used the same techniques as the US in developing recent exceptions clauses, namely the use of self-judging language and the inclusion of fact-specific exceptions clauses for financial emergencies and environmental disasters. Other States have employed alternative techniques in exceptions clauses, including the establishment of a clear hierarchy among the States' interests that give rise to an exception, reporting requirements among treaty parties for suspension of investment protections, and a diversity of consequences for the suspending State depending on the gravity of the interest protected in the exceptions clause. One of the most important aspects of other States' recent exceptions clauses, however, is their coherence within the treaty itself. To illustrate this coherence of exceptions within a single clause, this section presents exceptions clauses in their entirety from the most relevant treaties and model treaties.

1. The UK 2008 Model IPPA

The UK 2008 Model Investment Promotion and Protection Agreement (“IPPA”) contains—in one article, called “Exceptions”—both a general exceptions provision that provides national treatment or MFN treatment in undefined emergencies, and also a specific exceptions provision for times of financial emergency. As this provision states:

- (1) The provisions of this Agreement relative to the grant of treatment not less favourable than that accorded to the nationals or companies of either Contracting Party or any third State shall not be construed as to preclude the adoption or enforcement by a Contracting party of measures which are necessary to protect national security, public security or public order
- (2) Where, in exceptional circumstances, payments and capital movements between the Contracting Parties threaten to cause serious difficulties for the operation of monetary policy or exchange rate policy in either Contracting Party, the Contracting Party concerned may take safeguard measures with regard to capital movements if such measures are strictly necessary. The Contracting Party adopting the safeguard measures shall inform the other Contracting Party forthwith and present, as soon as possible, a time schedule for their removal.¹⁴⁶

146. United Kingdom Model Investment Promotion and Protection Agreement art. 7 (2), 2008 [hereinafter IPPA].

The first paragraph quoted above preserves the ability of the British government to block certain mergers under the Enterprise Act of 2002, and to send matters to review by a compensation commission.¹⁴⁷ This provision appears to provide significant freedom of action in the establishment phase of the investment, but does little to protect freedom of action once that investment has been made.¹⁴⁸

The second paragraph of this exceptions provision appears to have been added to the Model IPPA in 2006,¹⁴⁹ thus even before the financial crisis of 2008. This paragraph includes a reporting requirement for the State taking measures to address threats to its monetary or exchange rate policy. This reporting requirement likely serves to discourage frivolous or after-the-fact invocations of this provision, made only after an investment arbitration has been initiated. Seemingly, with this reporting requirement, if a State did not inform its treaty partner of the measure within a reasonable time of taking the steps in question, then the State did not actually intend for those measures to be deemed within the financial portion of this “Exceptions” provision.

This “Exceptions” provision in the UK Model IPPA is combined with a separate “Compensation for Losses” provision, which essentially provides for national treatment during times of war, national emergency, or similar circumstances:

- (1) Nationals of companies of one Contracting Party whose investments in the territory of the other Contracting Party suffer losses owing to war or other armed conflict, revolution, a state of national emergency, revolt, insurrection or riot in the territory of the latter Contracting Party shall be accorded by the latter Contracting Party treatment, as regards restitution, indemnification, compensation or other settlement, no less favourable than that which the latter Contracting Party accords to its own nationals or companies or to its nationals or companies of any third State. Restitution payments shall be freely transferrable.
- (2) Without prejudice to paragraph (1) of this Article, nationals or companies of one Contracting Party who in any of the

147. Chester Brown & Audley Sheppard, *United Kingdom, in* COMMENTARIES ON SELECTED MODEL BILATERAL INVESTMENT TREATIES 697, 742 (Chester Brown ed., 2013) (discussing the development of this article of the UK Model IPPA and recent treaties in which the article’s various provisions are included).

148. *Id.*

149. *Id.*

situations referred to in that paragraph suffer losses in the territory of the other Contracting Party resulting from

(a) requisitioning of their property by its forces or authorities, or

(b) destruction of their property by its forces or authorities, which was not caused in combat action or was not required by the necessity of the situation, shall be accorded restitution or adequate compensation. Resulting payments shall be freely transferrable.¹⁵⁰

When combined, the “Exceptions” and “Compensation for Losses” provisions of the 2008 UK Model IPPA provide a semblance of hierarchy of interests that might be invoked to justify an exception from investment treaty protections. Under the “Compensation For Losses” provision, for example, in a war, national emergency, or similar circumstances, foreign investors would receive essentially national treatment. The investor would not, however, be guaranteed fair and equitable treatment, full protection and security, or other particular protections provided in investment treaties. Environmental emergencies, however, do not warrant such a downgrade in investor protection, at least according to a plain reading of the clause. Such a difference in the treatment of these two interests appears to indicate that war is a more serious “interest” that therefore warrants a broader exception to investment protection than an environmental emergency.

In addition, the financial security provision in the “Exceptions” clause of the UK Model IPPA, as noted above, ensures that some leeway in treaty protections is available during times of economic crisis. The reporting requirement of that clause serves to limit the invocation of the clause and discourages after-the-fact invocations of the clause. In addition, the clause itself is limited so that even with a contemporaneous notification, the exception will only apply in “exceptional circumstances” causing “serious difficulties” and will protect only measures that are “strictly necessary.” Although this provision is not as detailed as the financial security provision in the 2012 US Model BIT, it does demonstrate that more than one State is concerned about the application of an investment treaty during times of financial crisis.¹⁵¹

150. IPPA, *supra* note 146, at art. 4.

151. Indeed, the Iceland-Mexico BIT also contains a specific clause relating to financial emergencies.

Although the 2008 UK Model IPPA exceptions provisions demonstrate some consideration of potential emergency situations, these provisions are not entirely foolproof. Like the relationship between the three separate exceptions provisions in the 2012 US Model BIT, the relationship between the “Exceptions” and “Compensation for Losses” provisions of the 2008 UK Model IPPA is unclear. Moreover, while the “Exceptions” provision appears to provide a great deal of protection to the host State’s freedom of action in permitting or forbidding the establishment of an investment, that protection does not continue throughout the life of an investment. Such short-lived freedom of action is unlikely to prove adequate to ensure a long-term balance of regulatory freedom with investment protection—indeed, such a provision would encourage the host State to be parsimonious in permitting the establishment of investments, because after the investment is established, the “balance” is shifted to the investor, and the host State can no longer regulate with a reasonable degree of sovereignty. Thus, although the UK Model IPPA offers some guidance on the structuring of exceptions clauses, particularly as to the use of reporting requirements, the UK approach does not necessarily warrant wholesale adoption.

2. The Latvian Model Treaty

A clearer hierarchy of interests is set forth in Article 13 of the Latvian Model BIT. This provision distinguishes logically between the consequences of war, as opposed to other aspects of public order or health. As this provision states:

1. Nothing in this Agreement shall be construed as preventing a Contracting Party from taking any action necessary for the protection of its essential security interests in time of war or armed conflict, or other emergency in international relations.
2. Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Contracting Party from adopting or maintaining measures, including environmental measures:
 - (a) Necessary for the maintenance of public order;
 - (b) Necessary to protect human, animal or plant life or health.

3. The provisions of this Article shall not apply to Article 5 [Expropriation], Article 6 [Compensation for losses] or paragraph 1(e) of Article 7 [payments pursuant to Articles 5 & 6] of this Agreement.

Under this provision, the hierarchy of exceptions norms is as follows: If a measure is necessary to protect essential security interests in a time of war or armed conflict, then the agreement's protections generally fall away. If the measure is necessary to maintain public order only, however, the measure must meet a higher standard—the measure must not be applied “in an arbitrary or unjustifiable manner” and must “not constitute a disguised restriction on international trade or investment.”¹⁵² Thus, as is logical from the history of necessity clauses, the Latvian Model treaty provision grants a State more freedom of action in responding to war than in responding to other types of emergencies.

In addition, this model provision demonstrates the consequences of measures that fall within each part of this provision—the investor will still receive damages for actions that constitute expropriation, but not for other potential violations of the treaty, such as a failure to grant fair and equitable treatment or a violation of full protection and security. Thus, although the State has greater freedom of action in response to a war as opposed to another type of emergency, the financial consequences to the State will be the same regardless of the type of interest invoked.

A potential weakness of this article, however, is its failure to include a provision specific to a financial emergency, and thus the failure to provide guidance on the consequences of such an emergency. The uniqueness of responses to a financial emergency—and the increasing need to preserve freedom of action in that area—perhaps warrants the inclusion of a subject-matter specific provision to that effect in every investment treaty. For this Latvian provision, financial security measures would be protected only if considered part of the “maintenance of public order.” Despite this flaw, the Latvian Model BIT provides helpful guidance for the US and other States examining their exceptions clauses, particularly in its clear establishment of a hierarchy of interests and discussion of the consequences of invoking an emergency exception.

152. Latvian Model BIT art. 13.

3. Japan-Korea BIT

A final example of forward-thinking exceptions clauses in global BIT practice is in the Korea-Japan BIT of 2003. Like the US Model BIT, this exceptions provision includes self-judging language. Like the Latvian BIT, it also sets out a clear hierarchy of interests that might warrant invocation of the exceptions clause. In addition, this provision contains a specific reference to environmental measures, reference to public order, and a reporting requirement. As the provision states:

1. Notwithstanding any other provisions in this Agreement other than the provisions of Article 11, 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.

2. In cases where a Contracting Party takes any measure, pursuant to paragraph 1 above, that does not conform with the obligations of the provisions of this Agreement other than the provisions of Article 11, that Contracting Party shall not use such measure as a means of avoiding its obligations.

3. In cases where a Contracting Party takes any measure, pursuant to paragraph 1 above, that does not conform with the obligations of the provisions of this Agreement other than the provisions of Article 11, that Contracting Party shall, prior to the entry into force of the measure or as soon thereafter as possible,

notify the other Contracting Party of the following elements of the measure:

- (a) sector and sub-sector or matter;
- (b) obligation or article in respect of which the measure is taken;
- (c) legal source or authority of the measure;
- (d) succinct description of the measure; and
- (e) motivation or purpose of the measure.

This provision has two innovative elements that combine to make it an extremely effective exceptions clause. First, the clause sets out examples of interests that might concern a State's "essential security" that serve to confine the term to matters related to war. By so limiting the definition of "essential security," the self-judging language in this provision of the Japan-Korea BIT becomes more palatable to the international community because, although the self-judging language might permit broad freedom of action, the ability to so act would apply only in limited factual circumstances, *i.e.*, in a war.

The second innovative element of this provision is its detailed notification requirement in Section 3 quoted above. A bare-bones notification provision, such as the one included in the 2008 UK Model IPPA, serves a general purpose of discouraging after-the-fact invocations of the clause. The more detailed requirement of the Japan-Korea BIT, however, serves additional purposes. By requiring the host-State to specify the sector and sub-sector in which the measure is taken, the notification requirement gives the host-State the incentive to limit the scope of the measure in question to that which is strictly necessary to address the emergency. By requiring the State to identify the legal source of the measure taken, this notification requirement helps ensure that the State will not violate its own law in taking measures in response to an emergency, thus providing greater predictability for investors. Finally, by requiring that the State note the obligation or article with respect to which the measure is taken, this notification requirement allows the host State to choose for itself the consequences of its emergency measures—for example, the State can notify its treaty partner that a certain measure will be excepted from all substantive obligations of the treaty except national treatment, or that only protection against expropriation will apply. By forcing the State to choose the consequences of its emergency measure, this notification requirement allows nuance for States

seeking to balance the ability to address emergency situations, while still retaining protection of investors.

A potential weakness of the exceptions clause in the Japan-Korea BIT is that it may be *too* permissive for the host State. This clause is phrased in positive terms—“each contracting party may” take certain measures—as opposed to the general practice of phrasing an emergency exception in negative terms—a measure in derogation may be taken “only if” or “Nothing in this agreement shall be construed to preclude.” Phrasing the emergency provision in such permissive language makes that clause not so much an exception, but more like a limiting clause to the treaty’s protection, and could discourage investment due to the breadth of freedom allowed to the host State at the expense of protection of investment.

C. Conclusions and Themes from Comparative Analysis

As the above-quoted comparative examples demonstrate, States have long been careful to preserve their freedom of action as a general matter in investment treaties. In recent years, States have also sought to specifically preserve their freedom to act in response to environmental disasters and financial disasters, as well as in times of war or revolution or public emergency. States have accordingly included fact-specific exceptions clauses in their investment treaties, and also expanded the language of general exceptions clauses to preserve an exit to treaty requirements during emergencies of unanticipated types. Despite expanding their freedom of action, States have maintained their commitment to investment protection by requiring notice to treaty parties when an exceptions clause is invoked and by offering at least limited compensation to the investors affected.

Recent global investment treaty practice presents three themes that could serve as guidance in the future US-China BIT, or in other US BITs. First, States generally permit some compensation for investment treaty violations, particularly when the measure causing the violation was in response to something less than war or revolution. Such a result is logical, given that, under the general hierarchy of interests that might give rise to an emergency exception, an environmental or financial disaster is seen as less of a threat to the existence of a State than a war.

A second theme from this comparative analysis, which could serve as a guide the US-China BIT negotiations, is the use of reporting or notification requirements to preserve investor protections in times of emergency. Reporting or notification serves as a form of restraint, and helps to prevent after-the-fact attempts to justify certain action based on imagined or manufactured concern for the environment, financial hardship, or other seemingly-legitimate circumstances. Such a reporting requirement, and the use of reporting, would have an effect that was exactly the opposite of a self-judging clause—rather than undermining the legitimacy of the plea because of its unmoored nature, the reporting requirement serves to support the legitimacy of a plea under one of these clauses by establishing the host State's reliance on that clause from an early date. A detailed reporting requirement, such as the one included in the Japan-Korea BIT may be the most useful because it requires the State to consider the scope and effect of its actions.

Finally, the United States and China could observe other States' differentiation of the consequences that flow from the invocation of differing interests as the source of the emergency. For the most significant interests which obviously threaten the existence of the State most seriously—such as responding to war—it may be that no investment protections apply. For other interests, where the threat to the existence of the State is less palpable, national treatment protections might apply or expropriation alone might remain prohibited. The establishment of clear and differentiated consequences for these different types of emergencies allows both States and investors to appreciate the status of an investment during a crisis of various types, and allows them to plan and balance the treaty's goals.

These three lessons lead to a logical proposal for alternative language for a potential emergency clause of the forthcoming US-China BIT. Such a proposal, and an explanation for the changes, is presented in the next section.

IV. *THE WAY FORWARD IN US BITS*

The foregoing analysis suggests that a well-considered exceptions clause would include (1) a hierarchy of interests that give rise to such exceptions; (2) a clear statement of the consequences of measures that fall within the exceptions clause; and (3) a requirement of timely notice by the host State to its treaty partner of any measure

taken in response to an emergency. Incorporating these three characteristics, the US-China BIT might include a clause along the lines of the following:

Art ###. Exceptions.

(1) Nothing in this treaty shall be construed to preclude a Party from taking

(a) measures 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, such as measures

(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) measures necessary to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.

(c) measures relating to financial services undertaken for prudential reasons, including the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial services supplier, or to ensure the integrity and stability of the financial system.

(d) measures relating to investors of the other Party, or covered investments, in financial institutions that are necessary to secure compliance with laws or regulations that are not inconsistent with this Treaty, including those related to the prevention of deceptive and fraudulent practices or that deal with the effects of a default on financial services contracts.

(2) This provision shall apply in addition to, and independent of any exceptions in customary international law.

(3) When a Party takes any measure, pursuant to paragraph (1) above, that Party shall, prior to the entry into force of the measure or as soon thereafter as possible, notify the other Party of the following elements of the measure:

- (a) sector and sub-sector or matter;
- (b) obligation or article in respect of which the measure is taken;
- (c) legal source or authority of the measure;
- (d) succinct description of the measure; and
- (e) motivation or purpose of the measure.

(4) If a measure falls within Part (1)(a) of this article, no compensation shall be due for any action that would be deemed violation of the treaty, but for the application of this provision.

(5) If a measure falls within Part (1)(b) to (1)(d) of this article, the investment shall be accorded national treatment.

(6) If a measure falls within Part (1)(c) or (1)(d) of this article, then the following provisions shall apply

- (a) [the 2012 US Model BIT provision that requires appointment of arbitrators with expertise in financial matters]
- (b) [the 2012 US Model BIT provision that allows the finance ministries of both States' party to the treaty to agree that the measure was taken in response to a financial emergency]
- (c) [the 2012 US Model BIT provision that allows for preliminary determination of the application of the financial services exception]

The text suggested above has several advantages over the exceptions provisions in the 2012 Model BIT. First, like the Latvian Model BIT, the suggested text sets out a clear hierarchy of interests that might warrant departure from the treaty norms, and—at parts (4) and (5)—defines the various consequences of invoking the exceptions clause. Like the 2008 UK Model IPPA, the clause provides for national treatment for all types of emergencies except war. The clause also includes a detailed notification requirement, like the Japan-Korea BIT, which will require the host State to consider the effects and scope of the measure it is taking. The suggested text retains the self-judging language for the essential security provision at part (1)(a), but like the Japan-Korea BIT, it includes language that clearly limits this essential security provision to time of war, when self-judgment would be most appropriate and least likely to unduly compromise investment

protection and cause concern among treaty partners. In addition, the text suggested above retains the extremely well-considered procedural provisions of the “Financial Services” provision of the 2012 Model BIT, and it includes a provision that clarifies the relationship—or lack of relationship—between the treaty provision and any concept of necessity in customary international law. Finally, the suggested text eliminates the ambiguous distinction between “measures necessary” and “measures appropriate” in the context of the environmental exception by simply applying the “necessary” language to all types of exceptions.

A clause such as the one suggested above would go a long way towards clarifying investor-State relations before any arbitrations arise, thus giving certainty to the parties’ obligations and leaving less to the whims of arbitral tribunals. In the US-China context, where the stakes are billions in investment and potentially billions in investment arbitration awards, clarity and certainty in treaty-drafting is required.

CONCLUSION

The forthcoming US-China BIT will spark not only new investment, but also new investment arbitration. Both States should prepare for this eventuality, and include in their treaty a sensible, practical exceptions provision that preserves the host State’s freedom of action, while balancing protection of investment. A comparative analysis of exceptions clauses in global BIT practice provides one pathway toward the framing of such a provision.

