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The rise of self-judging essential security interest clauses in international investment agreements

by
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A network of bilateral treaties and other international investment agreements (IIAs) has constructed a predictable and enforceable international investment regime.

Since 1992, however, the protections offered by this regime have potentially been limited by the inclusion in IIAs of self-judging essential security interest (ESI) clauses. These clauses expressly allow a government to take measures—unilaterally—that "it considers necessary"[1] to evade treaty obligations.

This *Perspective* presents a study of 1,861 IIAs concluded by 90 countries before early 2016.[2] The study sought to identify the geographic and temporal spread of self-judging ESI clauses in IIAs and trends in drafting styles. It found 222 IIAs containing self-judging ESI clauses, with the United States (US) being the first to introduce them. The US, Canada and Japan remain the leading users, followed by a growing number of Asian and Latin American countries.

While the number of self-judging ESI clauses is small compared to the total number of IIAs, the proportion of IIAs with such clauses concluded in a given year has increased from negligible in 2000 to over 60% of IIAs concluded in 2015. (See charts below.) By early 2016, at least 134 countries, accounting for 99% of world outward FDI flows and stock, were bound by such clauses.

Self-judging ESI clauses can be classified along two dimensions:

Scope

- "Broad clauses" (127 IIAs) refer to "essential security interests" without further definition or limitation, giving governments wide discretion to determine what

constitutes their ESI. For example: "Nothing in this Agreement … preclude[s] a Party from applying measures that it considers necessary for … the protection of its own [ESI]."[3]

- "Narrow clauses" (95 IIAs) limit self-judgment to specific subjects, typically related to furnishing certain information, but also to matters such as war or other emergencies. Occasionally, narrow clauses incorporate, by reference, or replicate, GATT art. XXI and/or GATS art. XIV bis.

Strength

- "Very strong clauses" (15 IIAs) include a footnote prescribing that arbitral tribunals must respect a government's determination of its ESI: "For greater certainty, if a Party invokes [ESI] … the tribunal or panel hearing the matter shall find that the exception applies."[4]
- "Strong clauses" (190 IIAs) state simply that they are self-judging.
- "Conditional clauses" (17 IIAs) subject self-judgment to a requirement that measures are not applied, for example, in an arbitrary or unjustifiably discriminatory manner, or so as to avoid treaty obligations.[5] This leaves the door open for arbitral review[6] (which can be explicitly required[7]), especially when treaties require reasons for invoking the exception.

The most far-reaching clauses, conferring maximum discretion on governments to determine their own compliance with treaty obligations, are "broad" and "very strong." Ten IIAs containing such clauses were identified, followed by 102 with broad/strong clauses and 88 with narrow/strong clauses.

Except perhaps when clauses are "very strong," most self-judging clauses could arguably be challenged on the basis of "good faith."[8] Nonetheless, arbitral tribunals must give great deference to the judgment of governments.[9]

Overall, the proliferation of self-judging ESI clauses makes IIA protections uncertain, subordinating treaty disciplines to governments' self-restraint. They are likely to spread further, as governments seek to protect ESI concerns and regulatory sovereignty, and could extend beyond security to cover financial and other regulation. Broad/strong self-judging ESI clauses are quite sweeping, creating the risk of abuses by governments.

Abuses could perhaps be limited by more narrow definitions of "essential security interests" and clearer delineations of when exceptions can be invoked (for example, limiting them solely to national security concerns, and/or expressly providing that they cannot apply to broader interests and economic issues); explicitly stipulating "good-faith" requirements; incorporating a last-resort condition; requiring notification or prior reasons given to a joint committee; and/or providing for consultations with treaty counterparties before invoking an ESI clause. Ultimately, however, the clauses remain self-judging.

Although the trend described in this *Perspective* might be part of the much-needed rebalancing of the investment regime toward greater rights for governments, care must be taken not to undermine the rule of international investment law in the process.

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[1] Or similar formulations establishing subjective self-judgment.

[2] The review drew on various databases and direct contacts with countries, but not all countries and IIAs were reviewed.

[3] US-Australia FTA, art. 22.2(b).

[4] *See*, *e.g.*, US-Peru FTA, art. 22.2. Whereas the US discontinued use of such a footnote since 2007, other countries have not.

[5] *See*, *e.g.*, Korea-Japan BIT, art. 16.

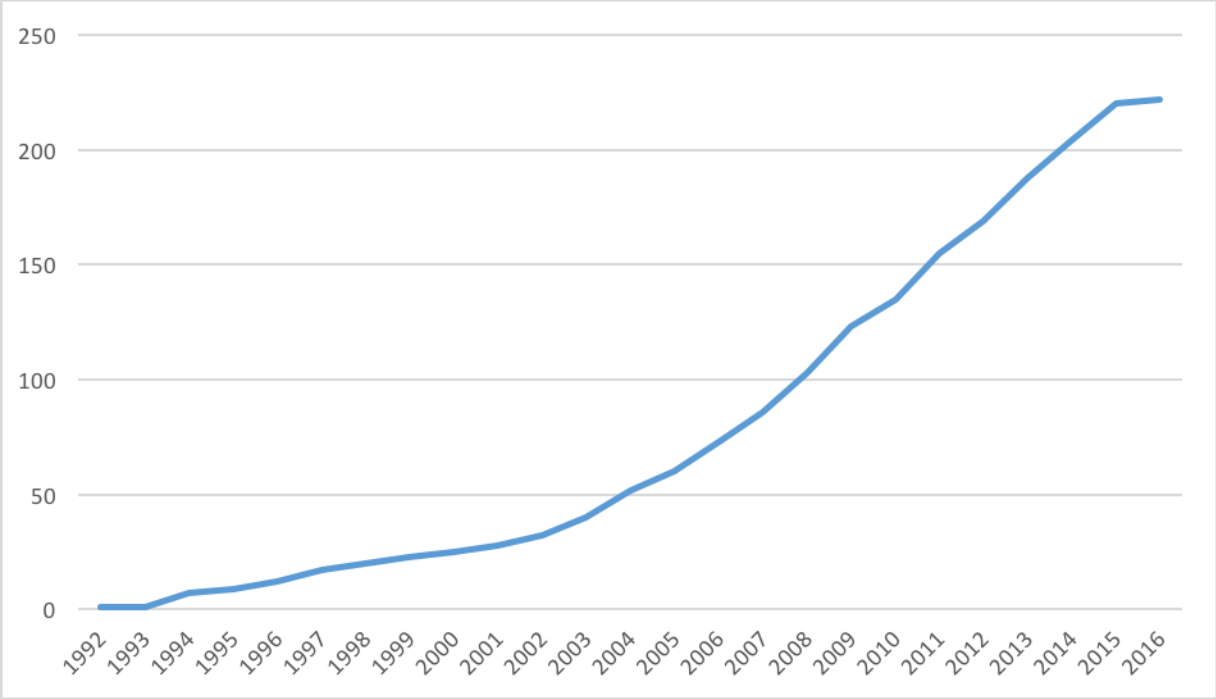
[6] *See*, *e.g.*, Japan-Mozambique BIT, art. 18.

[7] *See*, *e.g.*, China-Peru FTA, art. 141.

[8] *See*, *e.g.*, Kenneth Vandevelde, "Of politics and markets: the shifting ideology of the BITs," *International Tax & Business Lawyer*, vol. 11 (1993), at p. 159; Stephan Schill and Robyn Briese, "'If the state considers': self-judging clauses in international dispute settlement," *Max Planck Yearbook of United Nations Law*, vol. 13 (2009), pp. 61-140.

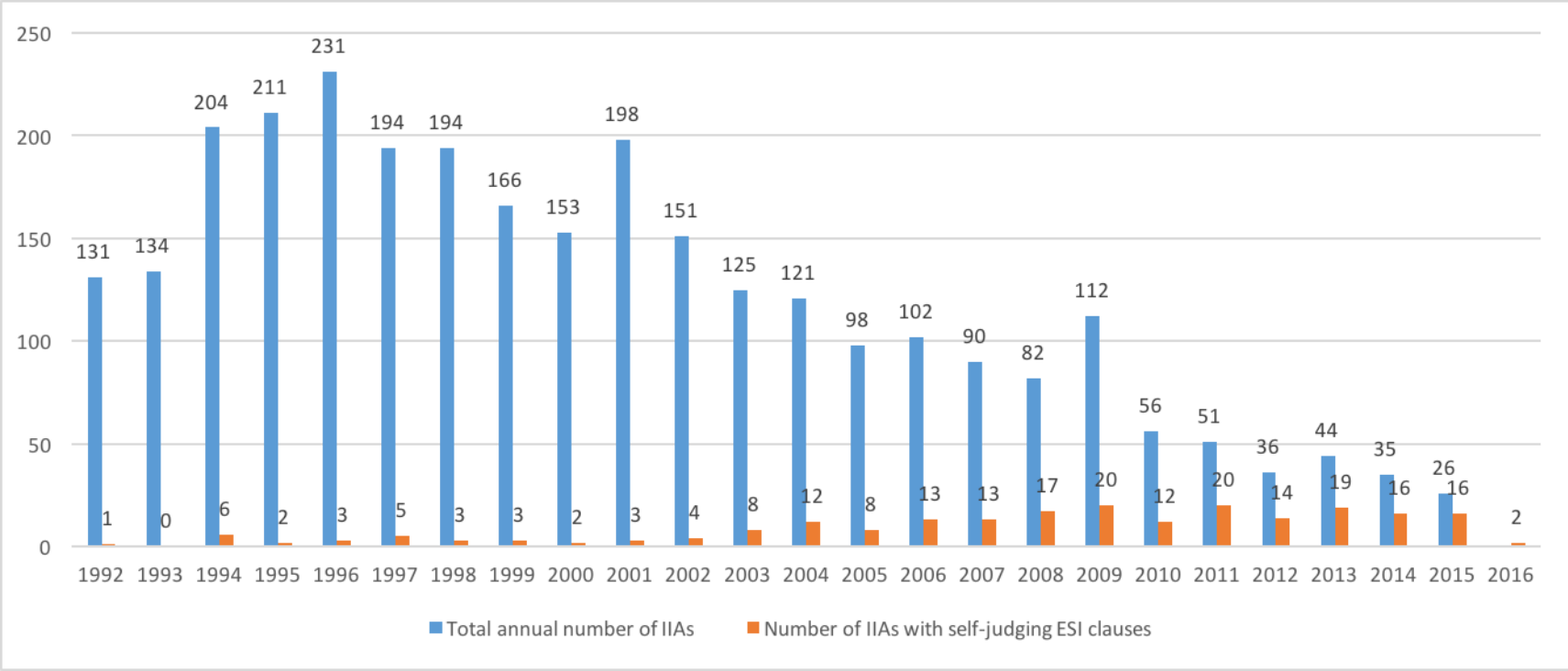
[9] Tribunals in investor-state arbitrations have not yet considered self-judging ESI clauses. The effect of self-judging provisions in other legal instruments (e.g., ICJ Statute, art. 36(2)) remains uncertain. *See*, *also*, *Interhandel (Switzerland v. US)* [1959] I.C.J. Rep. 6 (Judgment).

Figure 1. Cumulative number of IIAs signed with self-judging ESI clauses, 1992 - early 2016



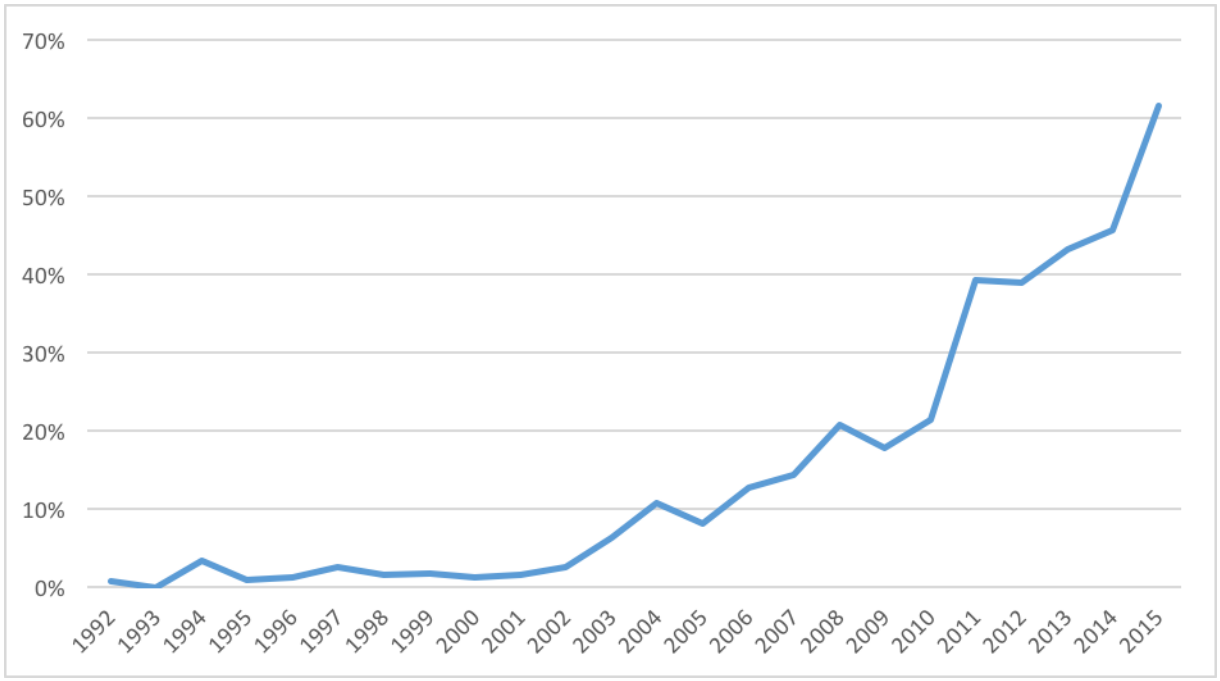
Source: UNCTAD IIA database for number of IIAs (http://investmentpolicyhub.unctad.org/IIA) and own research.

Figure 2. Number of IIAs signed per year and number of IIAs per year with self-judging ESI clauses, 1992 - 2016



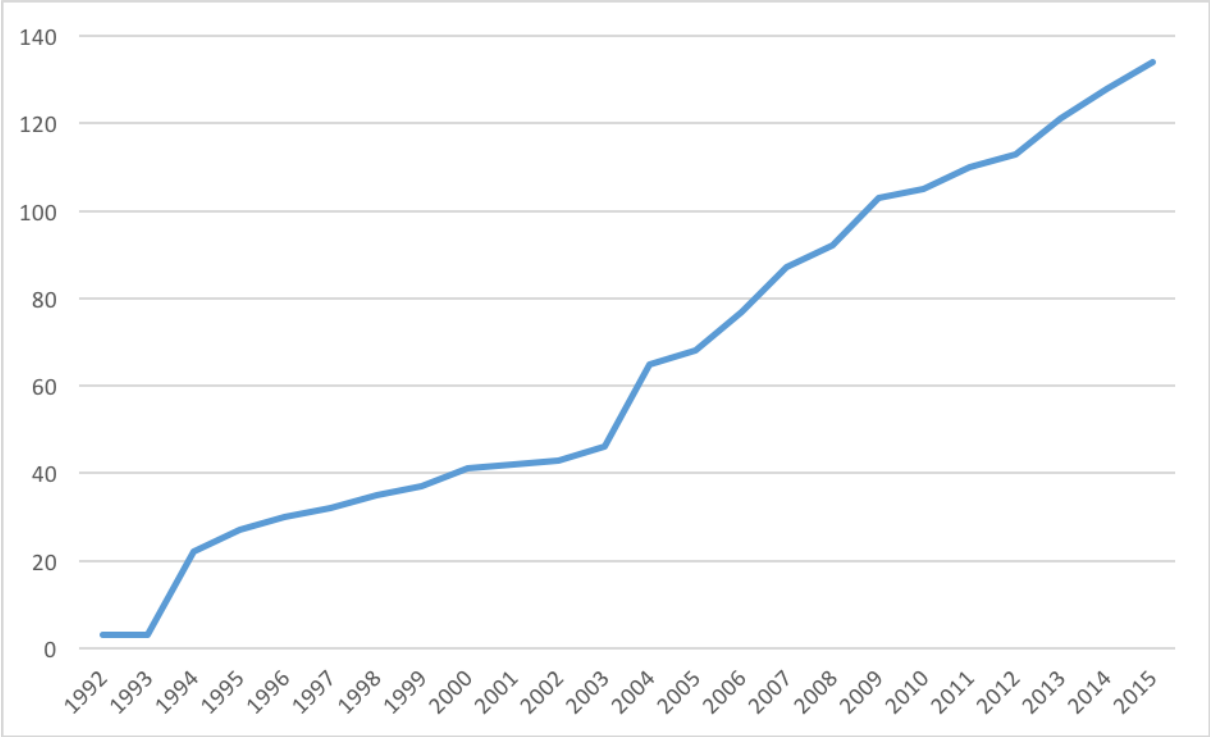
Source: UNCTAD IIA database for number of IIAs (http://investmentpolicyhub.unctad.org/IIA) and own research.

Figure 3. Percentage of IIAs signed with self-judging ESI clauses, by year, 1992 - early 2016



Source: UNCTAD IIA database for number of IIAs (http://investmentpolicyhub.unctad.org/IIA) and own research.

Figure 4. Cumulative number of countries with self-judging ESI clauses, 1992 - 2015



Source: UNCTAD IIA database for number of IIAs (http://investmentpolicyhub.unctad.org/IIA) and own research.

Table. Self-judging ESI clauses, by scope and strength

	Very strong self-judging element	Strong self-judging element	Conditional self-judging element
Broad ESI scope	10	102	15
Narrow ESI scope	5	88	2

Source: Own research.

For further information, including information regarding submission to the *Perspectives*, please contact: Columbia Center on Sustainable Investment, Daniel Allman, daniel.allman@columbia.edu.

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