

THE GLOBAL FINANCIAL CRISIS AND INTERNATIONAL ECONOMIC LAW

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EXECUTIVE SUMMARY

Economists and political scientist have begun to isolate the causes and implications of the spread of the global financial crisis in late 2008. Critical attention – often accompanied by strident disagreement – has also focused on the efficacy of various domestic plans implemented in response to the crisis. International lawyers have contributed little to these debates. Our analysis aims to partly redress this gap by examining whether and how international economic law might act as a credible constraint on state tendencies towards domestic preference when formalizing emergency responses to the crisis. We argue that international investment law is, in the short-term, more likely than any other area of international economic law to give rise to complaint and initiation of legal action. This may, in turn, act as some constraint against the growing protectionist tendencies evident across state responses to the crisis. We develop our argument by firstly offering a typology of typical emergency measures implemented by states, highlighting evidence of discrimination directed at foreign investors in many of those emergency plans. We then survey the various limitations on discrimination in international economic law focusing largely on the extensive network of international investment treaties. Our focus here is driven by the unique and enforceable rights accorded to foreign investors under these treaties to directly seek monetary compensation from signatory states for breaches of treaty obligations. We argue that there is a strong case to be made for liability of states under international investment law, a case bolstered by the critical absence of exceptions for state conduct in this area of international law.

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I. Introduction

Economists and political scientists have begun to isolate the causes and implications of the spread of the global financial and economic crisis in late 2008. Critical attention – often accompanied by strident disagreement – has also focused on the efficacy of various domestic plans implemented in response to the crisis. International lawyers have contributed little to these debates. Our analysis aims to partly redress this gap by examining whether and how international economic law might act as a credible constraint on state tendencies towards domestic preference when formalizing emergency responses to the crisis.

International economic law comprises a variety of sources, most notably commitments on trading relations and the treatment of foreign investors. The former – international trade law - encompasses bilateral free trade agreements, regional instruments such as the North American Free Trade Agreement and the multilateral World Trade Organization (WTO). In comparison, the latter – international investment law – is largely confined to a network of bilateral investment treaties but also includes key aspects of customary international law.

We believe that international investment law is, in the short-term, more likely than any other area of international economic law to give rise to complaint and initiation of legal action. This may, in turn, act as some constraint against the protectionist tendencies evident across state responses to the crisis. There are three critical factors that might trigger international investment litigation where states have regulated in a discriminatory fashion against foreign investors in the aftermath of the crisis. First, the scope of most investment treaties is typically broader than instruments of trade law (and especially the WTO). This is particularly apparent in the relative absence of exceptions for state conduct under most investment treaties, compared to the detailed and elaborate carve-outs such as the prudential exception in the Annex on Financial Services of the WTO General Agreement on Trade in Services. Second, in traditional systems dispute settlement at international law (such as in the WTO), the right to initiate a dispute is vested only in state signatories to the relevant treaty. This has important limiting effects in the context of the current crises as states may rationally refrain from invoking their legal rights against each other given their own (discriminatory) attempts to respond to the crisis and the possibility of attracting retaliatory litigation.¹ Investment treaties

¹ Although the Brazilian Foreign Minister Celso Amorim said that Brazil may challenge the legality of a "Buy American" clause in the recently approved U.S. economic stimulus package at the World Trade Organization,

displace this default position by conferring standing on a private party, foreign investors of a signatory state. The foreign investor has the right to initiate action against a host (signatory) state in a range of institutional *fora*, including the World Bank's Convention on the Settlement of Investment Disputes Between States and Nationals of Other States² (ICSID). There is thus no political filter at play in this system; a foreign investor will consider only the commercial imperatives for initiating action and recouping loss caused by state conduct. Third and perhaps most crucially, international investment law is characterized by a range of hard, enforceable remedies adding further incentive to commencement of international litigation. In investment arbitration, the remedy nearly always consists of monetary compensation for loss suffered by the foreign investor. Significant monetary awards have been issued against states under this system, including Argentina who was found to be in breach of investment treaty obligations in the aftermath of its 2001-2 financial crisis.³

We begin our analysis in the next Part II by offering a typology of the typical emergency measures implemented by states to date that are at the greatest risk of breaching commitments under international economic law. We focus here on the early evidence of discrimination directed at foreign investors in the financial sector in the emergency plans of a number of developed states. These varied forms of discrimination are highly likely to constitute breach of obligations of states under international investment law. To fully contextualize our analysis, we briefly consider in Part III the legal situation under select areas of international trade law. Our primary focus is, however, international investment law which we turn to in Part IV. There we review the various forms and sources of international investment law including Treaties of Friendship Commerce and Navigation, Bilateral Investment Treaties (BITs), Customary International Law (CIL) as well as the OECD National Treatment Instrument. We identify potential violations of investment law norms across the different categories of surveyed measures. We focus here on two key treaty obligations being the specific protection against discrimination of foreign investors in the obligation of national treatment, as well as the broader guarantee of fair and equitable treatment. Part V then assesses the remote possibilities of escaping liability through prudential carve-outs and

see Raymond Colitt, Brazil may challenge "Buy American" at WTO, Reuters UK, News of 17 February 2009, available at: <http://uk.reuters.com/article/usPoliticsNews/idUKTRE51F52920090217>.

² Covenant on the Settlement of Investment Disputes between States and National of Other States, signed in Washington 18 March 1965, entered into force 24 October 1966, 575 UNTS 159; 4 ILM 524 (1965).

³ UNCTAD, Latest Developments in Investor-State Dispute Settlement, IIA Monitor No. 1, 10 (2008) (detailing that, in 2007 alone, five investment tribunals awarded foreign investors a total of US\$615 million in damages against Argentina).

security exceptions in (some) BITs or CIL. Part VI ties these lines of inquiry together and concludes.

II. A Typology of Measures taken by the States

States have taken different measures in order to save their financial sector and to mitigate the economic downturn. Almost all of those measures were introduced in a very short time period and are often subject to continuing changes. Many measures are codified in law but delegate significant discretion to the executive branch. As these laws are often imprecise, and without implementing regulation, the regulatory landscape resembles somewhat of a “moving target”. Nevertheless, we will try to categorize the most frequently taken measures with specific relevance to state commitments under international economic law. .

These emergency measures can be grouped into three categories: 1) measures designed to bolster the stability of the financial services industry; 2) measures directed at the financial services industry but structured to increase the availability of credit to other sectors of the economy; 3) measures targeting select and strategic industries (including the automotive industry).⁴ We set out below an analysis of individual state measures highlighting evidence of discrimination against foreign actors before examining whether and how this might attract liability under international economic law.

1. Category 1: Measures Directed at the Financial Services Industry

The extensive measures undertaken in this first category are designed to increase the confidence of various market participants and to ensure the continuation of bank funding. They encompass liquidity support, recapitalisation (through nationalisation or otherwise), purchase of specific assets (including “toxic” bank assets), inter-bank (wholesale) lending guarantees and increases in retail deposit guarantees. We find firm evidence of discrimination directed at foreign investors across these various state measures.

⁴ Report to the TPRB from the Director-General on the Financial and Economic Crisis and Trade-Related Developments, (26 March 2009) provides in Annex 2 an overview over the measures taken so far, available at: http://www.wto.org/english/news_e/news09_e/trdev_dg_report_14apr09_e.doc.

Australia, for example, introduced an insurance scheme both for retail deposits and wholesale lending in early October 2008.⁵ The coverage of both guarantees was initially limited to Australian-owned banks and credit unions and Australian incorporated subsidiaries of foreign institutions. Branches of foreign banks – such as Citibank, Credit Suisse and UBS – were excluded from the insurance scheme. This exclusion triggered flight of wholesale capital from foreign bank branches to domestic guaranteed institutions.⁶ Australia is not alone in building adverse incentives for regulatory arbitrage in this area. Ireland has also temporarily guaranteed deposits, covered bonds, senior and dated subordinated debt but only in the six biggest banks of that country, reportedly leading to shifts in deposits to the perceived safety of those guaranteed institutions.⁷

Germany's general program on financial stabilization establishes a fund to stabilize the financial market by overcoming liquidity shortages and by creating framework conditions for strengthening the capital base of financial institutions. The Act covers *only* financial institutions with their seat in Germany, thereby excluding subsidiaries of foreign banks and foreign branch operations.⁸ It enables the executive to take various measures, *inter alia*, to assume debt instruments issued by and liabilities accrued by financial-sector enterprises up to an amount of 400 billion Euro and to guarantee liabilities of special purpose vehicles which have assumed risk positions of a financial-sector enterprise.⁹ Furthermore, the fund may recapitalize financial-sector firms by acquiring shares or silent participations.¹⁰ It may also overtake risk positions, that is, buy toxic assets, such as receivables, securities, derivatives, rights and obligations from loan commitments.¹¹ Interestingly, under the law, all measures taken are immediately enforceable and objections are excluded. Any action for rescission against measures under the Act and the ordinances based on this Act do not have the effect of delaying proceedings.¹² Also, the Federal Administrative Court is the first and last instance adjudicating disputes under the Act (except measures with constitutional implications).¹³

⁵ Financial Systems Legislation Amendment (Financial Claims Schemes and Other Measures) Act 2008 (Cth); Banking Amendment Regulations 2008 (No.1) (Cth).

⁶ Gemma Daley, "Australia Refuses Deposit Guarantee for Foreign Banks", Bloomberg (21 October 2008), www.bloomberg.com (accessed 18 November 2008).

⁷ See for an overview on the development on deposit insurance schemes in the crisis, Sebastian Schich, Financial Crisis: Deposit Insurance and Related Financial Safety Net Aspects, OECD 2008.

⁸ Sec. 2 para. 1 of the Financial Market Stabilization Act - Finanzmarktstabilisierungsgesetz of October 17, 2008.

⁹ Sec. 6 para. 1 of the Financial Market Stabilization Act.

¹⁰ Sec. 7 para. 1 of the Financial Market Stabilization Act.

¹¹ Sec. 8 para. 1 of the Financial Market Stabilization Act.

¹² Sec. 15 of the Financial Market Stabilization Act.

¹³ Sec. 15 of the Financial Market Stabilization Act.

The program in the United Kingdom has a broader scope by covering subsidiaries of foreign institutions (as authorized deposit takers).¹⁴ In contrast, Switzerland has elected to only bail-out specific institutions taken to be of systemic importance for the financial place Switzerland.¹⁵ To date, the benefits of this *ad hoc* program have only been extended to a national bank – UBS - with a promise to do the same for another, Credit Suisse. Since for now, no other bank of nation-wide importance is mentioned in the ordinance, one may assume that the bail-out measures are confined to these domestic actors.

Finally, the position under U.S. law and practice is more nuanced. Early proposals put forward by Secretary of Treasury Henry Paulson excluded foreign banks from the coverage of the U.S. bailout plan. Following concerted lobbying, the Emergency Economic Stabilization Act of 2008¹⁶ now authorizes purchase of distressed assets (especially mortgage-backed securities) in financial institutions if they have “significant operations” in the U.S. The face of the Act then allows for the possibility of foreign bank participation in the U.S bailout scheme. This absence of formal differentiation though should be seen in light of the significant discretion vested in the Treasury Department under the Act. Early reports suggest that domestic U.S institutions are the majority if not exclusive recipients of capital injections under the scheme.¹⁷ Similarly, the “Public-Private Investment Programme” within the Troubled Assets Relief Program foresees the buying of “toxic assets” up to 1 trillion USD but also limits access to institutions with “significant operations” in the US. If this trend continues, there may be differentiation against foreign institutions as a matter of fact,¹⁸ even if not on the face of the law.

¹⁴ HM Treasury, Statement on the Government’s asset protection scheme, January 19, 2009.

¹⁵ Botschaft zu einem Massnahmenpaket zur Stärkung des schweizerischen Finanzsystems of November 5, 2008, at 8969. They are well aware of the creation of competitive disadvantages (also of Swiss banks in other countries) but maintain that supporting measures are only available to Swiss banks.

¹⁶ Public Law 110-343.

¹⁷ See New York Times, October 14th 2008, available at: <http://www.nytimes.com/imagepages/2008/10/14/business/14bailout.graphic2.html>. The list until now contains only financial institution incorporated in the United States.

¹⁸ The development of bond prices of those institutions receiving aid by the state show the immediate effect – their prices go up. This might well be used as a proxy for refinancing costs, crucial for competitive conditions of the market.

2. Category 2: Conditional Measures – Provision of Credit

The second type of measures also addresses the banking industry but is meant to foster credit to the non-financial industry. The UK¹⁹ as well as Germany²⁰ stress in their bail-out plans that credit to national industry, especially SME is one of the conditions to be imposed on banks in case they take part in the type 1 measures. Since credit availability is scarce in the moment, lending to foreign industry may thus be restricted. In Switzerland, the Swiss Federal Banking Commission (SFBC) has agreed with Credit Suisse and UBS to raise current capital adequacy requirements by 2013. The banks will have to comply with a leverage ratio in addition to their risk-based capital adequacy requirement,²¹ but the domestic lending activities are exempted from the leverage ratio.²² This exemption for domestic lending activities sets strong incentives for preferring domestic debtors and potentially shifts available credit away from foreign firms. These various biases towards domestic lending also have a broader spillover effect. Developing countries now face a severe financing shortfall as investors (including foreign banks) pull resources out of emerging markets to either meet home country conditions or take advantage of lower risk, newly guaranteed markets in developed states.²³

3. Category 3: Measures Targeting “Strategic” Sectors

The third category of measure is the most recent and targets strategic industry sectors. In the U.S for instance, there are proposals to limit production subsidies for the automotive sector to sites that have been in operation for at least twenty years.²⁴ This condition has the effect of

¹⁹ HM Treasury, Statement to the House of Commons on Bank Lending, January 19th, 2009: „support small and medium businesses“; „The government could now own up to 70 per cent of RBS (Royal Bank of Scotland). In return for this, we have agreed with them an extension of lending commitments to large companies, and an increase in lending over £6bn in the next 12 month....These agreements will be specific –covering both the quantity and the type of lending made available to people and businesses across the country...“

²⁰ Sec. 10 para. 2 (1). Financial Market Stabilization Act.

²¹ The leverage ratio defines the proportion of core capital to total assets and it will be set for both banks at a minimum of 3% at group level and at 4% for the individual institutions.

²² Media Release of SFBC of 4. December 2008 (available at: <http://www.finma.ch/archiv/ebk/e/publik/medienmit/20081204/mm-em-leverageratio-20081204-e.pdf>) which somehow changes the Verordnung über die Eigenmittel und Risikoverteilung für Banken und Effektenhändler (Eigenmittelverordnung, ERV) of 29. September 2006 (last changed 1. January 2009).

²³ World Bank, “Swimming Against the Tide: How Developing Countries are Coping with the Global Crisis”, Report prepared for the G20 Finance Ministers and Central Bank Governors, 13-14 March 2009, and World Bank News Release No. 2009/245/EXC; WTO, Report to the TPRB, supra note 4 . See also Anthony Faiola and Mary Jordan, “British Bank to the World Takes Its Cash Back Home: Battered RBS Caught in Protectionist Storm”, The Washington Post (March 28, 2009), at A1 and A10 (detailing Royal Bank of Scotland’s planned closure of branch operations in 15 countries undertaken to comply with the domestic lending requirements of the UK bail-out scheme).

²⁴ “Energy Independence and Security Act of 2007”; SEC. 136. ADVANCED TECHNOLOGY VEHICLES MANUFACTURING: INCENTIVE PROGRAM. (g) PRIORITY.—The Secretary shall, in making awards or

confining those subsidies to the ‘Big Three’ U.S automakers, along with one production facility maintained by Toyota in California, since all the other production sites of foreign carmakers are younger than twenty years. Such differential effect may constitute impermissible discrimination under international investment law if foreign car makers who have invested in the U.S do not – as a class – qualify for those subsidies.²⁵

Furthermore, the recently passed U.S stimulus package - the American Recovery and Reinvestment Act of 2009 (ARRA)²⁶ – forbids the use of public funds for projects involving public works “unless all of the iron and steel used in the project is produced in the United States”.²⁷ Similarly, Sec. 604 (a) ARRA provides that “Except as otherwise provided ..., funds appropriated or otherwise available to the Department of Homeland Security may not be used for the procurement of [specified items of clothing or equipment] if the item is not grown, reprocessed, reused, or produced in the United States.” These measures have trade-distorting potential even with the provision, added by President Obama, that they “shall be applied in a manner consistent with United States obligations under international agreements.”²⁸ The U.S has historically maintained limited “Buy American” laws, but these older mechanisms have been carved-out by negotiation from U.S commitments at international law. There is no such fail-safe in operation for the new scheme which raises serious compliance concerns with both WTO law (especially subsidy commitments) and international investment law.

III. Potential Violation of International Trade Law

International trade law comprises the multilateral treaty instruments of the WTO as well as a variety of bilateral and regional trade agreements. We expect this body of treaty law to act as a firm limit on resort to traditional and identifiable forms of protectionism, such as increases in tariffs above bound levels and resort to unjustifiable trade remedies (especially anti-dumping measures). It is far more difficult to predict the likely influence of trade law on the nuanced forms of protectionism surveyed in Part III above. This is both due to the hidden or

loans to those manufacturers that have existing facilities, give priority to those facilities that are oldest or have been in existence for at least 20 years. Such facilities can currently be sitting idle.”

²⁵ Measures like car premiums to buy new cars are not discriminatory if they do not put any conditions on the origin of the new car, as is done by Germany, see <http://www.bafa.de/bafa/de/wirtschaftsfoerderung/umweltpraemie/index.html>

²⁶ Public Law 111-5, signed into law by President Obama 17th Feb. 2009.

²⁷ Sec. 1605 (a).

²⁸ Sec. 1605 (d) and Sec. 604 (k).

embedded nature of the discrimination practiced and the complexity of the trade instruments in question. We identify below some of these complexities in two key instruments, being the WTO General Agreement on Trade in Services (GATS) and the WTO Agreement on Subsidies and Countervailing Measures (SCM). These are not the only WTO commitments that might apply²⁹ nor is our analysis intended to be comprehensive. The next part distills a set of critical issues surrounding the application of these WTO instruments as part of a comparative exercise to identify the potentially broader scope of operation of international investment law, dealt with in Part IV.

As a start point, the GATS Agreement is relevant for the category 1 and 2 measures that intervene in the financial services industry. The GATS covers measures that affect “trade in services”, which is defined to include provision of a service through commercial presence. This can encompass foreign investment in the banking and finances sector, regardless of the form and organization of the investment vehicle.³⁰ The national treatment Article XVII of the GATS enjoins discrimination directed foreign services and foreign services suppliers. There are, however, a series of limiters that might constrain the likelihood of a dispute being brought before the WTO based on these GATS provisions. For one thing, specific commitments – including the national treatment Article XVII – *only* apply if a WTO member state has chosen to list the financial services sector as subject to those commitments. Even if this requirement is satisfied, there is a specific Annex on Financial Services in the GATS that preserves the ability of States to adopt and maintain measures for prudential reasons, including those for the stability of the financial system.³¹ This exception may offer a safe harbour for those state measures (such as the Swiss intervention) that are justified publicly on systemic and stability grounds.³²

²⁹ Two further possible candidates include the plurilateral WTO Agreement on Government Procurement and the Agreement on Trade-Related Investment Measures

³⁰ See Art. XXVIII (d) GATS: „commercial presence" means any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service.“

³¹ Annex on Financial Services, para. 2 (a): “Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement.”

³² One should bear in mind however that the prudential exception is limited by certain good faith requirements including that “such measures shall not be used as a means of avoiding the Member’s commitments or obligations under the Agreement”. Ibid. This exception has not been adjudicated in the case law but the good faith qualifications are similar to parts of the chapeau to GATT Article XX. On this latter point, see Eric Leroux,

Secondly, the various guarantees and government benefits in the category 1 to 3 measures may potentially violate the disciplines on the provision of domestic subsidies in the WTO SCM Agreement. A “subsidy” is defined as encompassing four basic elements: (i) a financial contribution³³ (ii) by a government or any public body within the territory of a Member³⁴ (iii) which confers a benefit³⁵ (iv) to a specific recipient.³⁶ All of these elements must be satisfied in order for a subsidy to exist. The SCM Agreement distinguishes between prohibited and actionable subsidies.³⁷ Prohibited subsidies are those which are conditional on export performance or upon local content requirements³⁸, while actionable subsidies require a complaining country to prove that the measure has caused it “adverse effects” (which includes material injury to domestic industry or serious prejudice to the state’s interests)³⁹. Depending on implementation, some of the benefits and guarantees extended by states responding to the crisis might constitute actionable subsidies. There are strategies however by which states can protect themselves from liability in this area. For example, measures which target consumption (and not production) leaving consumers free to choose the goods and services that they purchase, are unlikely to violate the SCM Agreement.⁴⁰

Under the SCM Agreement, a country can use the WTO’s dispute-settlement procedure to seek the withdrawal of the subsidy or the removal of its adverse effects (the multilateral avenue). Alternatively, the country can launch its own investigation and charge extra

Trade in Financial Services under the World Trade Organisation, 36 *Journal of World Trade* 2002, pp. 413-442, 430 et seq.

³³ Those are, e.g., grants, loans, equity infusions, loan guarantees, fiscal incentives, the provision of goods or services, the purchase of goods.

³⁴ This applies not only to measures of national governments, but also to measures of sub-national governments and of such public bodies as state-owned companies. If there are by now formerly private banks state owned which give credit to national firms which they would not have obtained otherwise in the market, those would be included. Furthermore, Art. 1.1. SCM distinguishes direct and indirect subsidies; in the latter the funds are channeled through private institutions, thus a link to a government agency needs to be found. Type II measures could constitute indirect subsidies.

³⁵ Often the existence of a benefit and its valuation will be clear. This is especially the case in the Type 1 Measures. In case of doubt, the Appellate Body uses the private investor test, that is, the existence of a benefit is to be determined by comparison with the market-place (i.e., on the basis of what the recipient could have received in the market); see *Canada – Aircraft*, WT/DS70 *Brazil*). Art. 14 SCM Agreement provides some guidance with respect to determining whether certain types of measures confer a benefit.

³⁶ There are four types of “specificity” within the meaning of the SCM Agreement, of which two are of interest here: Enterprise-specificity where a government targets a particular company or companies for subsidization; or industry-specificity where a particular sector or sectors is targeted for subsidization.

³⁷ Non-actionable subsidies no longer exist, Art. 8 SCM Agreement. They included subsidies for environmental purposes, to make up for regional inequalities, and the promotion of R&D. They were included on a provisional basis for five years ending 31 December 1999, subject to review (Art. 31 SCM) but there was no agreement on extension.

³⁸ A detailed list of export subsidies is annexed to the SCM Agreement;

³⁹ Art. 5-6 SCM Agreement.

⁴⁰ Report to the TPRB, supra note 4, para. 8.

countervailing duty on subsidized imports that are found to be hurting domestic producers (unilateral avenue).⁴¹ To do so, a member state must show the existence of a subsidies scheme, an injury to its domestic industry producing a like product and a causal link between those two. A threat of injury suffices for a lawfully imposed countervailing duty (Art. 15 SCM).⁴² There may however be important extra-legal and political economy factors that restrain use of these legal avenues. There is widespread use of subsidies in the various emergency measures adopted by a significant proportion of the WTO membership. A choice of a given member to initiate either a WTO complaint or a unilateral response might in turn trigger retaliatory action on the part of the targeted state. This potential for reciprocity of legal action inherent in international trade law is largely absent in international investment law. Investment treaties instead confer standing on foreign investors (of a signatory state) to bring legal action against another signatory state and there is no possibility for retaliation by the targeted state. This critical difference may leave investment treaties as the most likely and promising forum to challenge discriminatory state measures,.

IV Potential Violations of International Investment Law

What implications might flow under international investment law from these various differentiations between foreign and domestic actors? It is difficult to formulate a single answer given the heterogeneity of the almost 2800 legal instruments in the field. There are, for instance, important textual differences in the formulation of key protective norms, such as “national treatment” and “fair and equitable treatment”. Moreover, certain investment treaties include exceptions for national security and prudential regulation, while these are absent in other instruments. Last, but not least, the jurisprudence on the relevant norms is often fractured and conflicting, which may again impact on a given reading. With these factors in mind, we set out below a survey of the key forms of international investment law.

1. OECD National Treatment Instrument

We will deal first with the non-binding National Treatment Instrument of the OECD, since it reveals a common understanding of OECD states on how to understand the requirement to accord national treatment to foreign investors. It forms part of the Declaration on

⁴¹ Those forms of relief may not be used simultaneously, see footnote 35 to the SCM Agreement.

⁴² United States-Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada (WTO Doc WT/DS257/AB/R of 19 January 2004, para. 7.60).

International Investment and Multinational Enterprises and a procedural OECD Council Decision, which obliges adhering countries to notify their exceptions to National Treatment.⁴³ Although it is not binding, states have consented to a procedure of notification and negotiation of their exceptions to Instrument thus fostering transparency. The exceptions are periodically examined by the Investment Committee. These examinations result in a decision by the OECD Council, which formulates proposals for action by the country concerned. The results of the examinations are published in the series OECD Reviews of Foreign Direct Investment. Typically, the exceptions cover sectors like mining, transport, fisheries, broadcasting and telecommunications as well as real-estate. Exceptions to national treatment cannot be found in the banking sector concerning stabilizing measures, just as there are no exceptions concerning state aid for finance and automotive sectors.

As the OECD defines it, "national treatment" is the "commitment by a country to treat enterprises operating on its territory, but controlled by the nationals of another country, no less favourably than domestic enterprises in like situations."⁴⁴ The exceptions to be notified are classified and encompass mechanisms like "official aids and subsidies", "government purchasing" and "access to local finance". Differential treatment of national and foreign investors concerning state aid and government procurement thus seem to be accepted by the OECD states (together with eight non-member countries) as contrary to the National Treatment Instrument. To put this slightly differently, as these measures would be a violation of the Instrument, member states would be obliged to notify them as exceptions.

With this in mind, the explicit differentiations based on nationality evident throughout categories 1 to 3 are likely to violate the national treatment code of the OECD countries. A notification of exceptions now, would breach a standstill agreement.⁴⁵ These breaches will not give rise to justiciable disputes, as the instrument is non-binding. Investors must rely on their home countries to raise these issues in the OECD Investment Committee. The Instrument is likely to have a broader impact than this initial output. It may well inform a common understanding of the OECD states (and the eight non-member countries) of the

⁴³ Adhering to it are the thirty OECD member countries and eleven non-member economies: Argentina (22 April 1997), Brazil (14 November 1997), Chile (3 October 1997), Egypt (11 July 2007), Estonia (20 September 2001), Israel (19 September 2002), Latvia (9 January 2004), Lithuania (20 September 2001), Peru (25 July 2008), Romania (20 April 2005) and Slovenia (22 January 2002).

⁴⁴ OECD, 2008, National Treatment for Foreign-Controlled Enterprises Including Adhering Country Exceptions to National Treatment, available at: <http://www.oecd.org/dataoecd/32/21/1954854.pdf>, p. 5.

⁴⁵ In 1988, an unanimous pledge of all adhering countries to refrain from introducing new exceptions ("standstill pledge").

scope of national treatment protection, as the wording of the OECD Instrument is almost identical to many investment treaty formulations. Indeed, the Instrument has been pivotal in a number of investor-state cases in guiding the interpretative choices of arbitral tribunals, which we examine later in the paper.⁴⁶

2. Treaties of Friendship, Commerce and Navigation

Most modern bilateral investment treaties (BITs) are signed between developed and developing states. On first view, this typical country pairing might preclude claims by foreign investors of OECD states against other OECD countries, even though a significant proportion of global financial transactions take place within the OECD grouping. There are however two possibilities that might allow for a claim by this class of investor against an OECD state. First, an investor of an OECD state may partly structure their business operations through a developing country to take advantage of select BIT protections.⁴⁷ Second, older investment commitments – including Friendship, Commerce and Navigation treaties (FCN)⁴⁸ – remain in operation across a range of OECD states. For example, the U.S has FCN treaties in operation with both Germany⁴⁹ and Japan⁵⁰. These treaties usually allow disputes to be brought before the International Court of Justice⁵¹ and, at least in the case of the U.S, may be self-executing as a matter of U.S constitutional law giving investors of a state party the ability to initiate claims before U.S courts.⁵² This latter aspect may be particularly pertinent for (German and Japanese) foreign investors who are excluded from the “Buy American” procurement conditions of the American Recovery and Reinvestment Act 2009 as it offers them a potential avenue of complaint within the U.S judicial system. The primary FCN provision involved in

⁴⁶ For example, see *SD Myers, Inc. v Canada*, UNCITRAL Award under the NAFTA (13 November 2000, at para 248; *Pope & Talbot Inc v Canada*, UNCITRAL Award under the NAFTA (10 April 2001), at para 78 (and footnote 73)

⁴⁷ While this is a commonly accepted strategy within the jurisprudence, it has occasionally elicited criticism by arbitral tribunals. For example, see *Phoenix Action, Ltd. v Czech Republic*, ICSID Case No. ARB/06/5, Award (15 April 2009).

⁴⁸ After the Second World War, the so-called Modern FCN Treaty Series contained provisions on MFN status or national treatment, but also on the protection from expropriation without prompt, adequate, and effective compensation, see Andreas Paulus, *Treaties of Friendship, Commerce and Navigation*, Max Planck Encyclopedia of Public International Law available at: www.mpepil.com

⁴⁹ Signed at Washington D.C., October 29, 1954, entered into force July 14, 1956, available at: http://tcc.export.gov/Trade_Agreements/All_Trade_Agreements/exp_005539.asp.

⁵⁰ Signed at Tokyo April 9, 1953, entered into force October 30, 1953.

⁵¹ As, e.g. *Case concerning Elettronica Sicula SpA (ELSI)* (United States of America v Italy) [1989] ICJ Rep 15.

⁵² See *Asakura v City of Seattle*, 265 US 332 (1924), *Spiess v C. Itoh & Co. (America), Inc.* United States Court of Appeals Fifth Circuit [24 April 1981] 356; *McKesson HBOC, Inc. v. Islamic Republic of Iran* United States Court of Appeals for the District of Columbia Circuit [16 November 2001] 1107–8.

actions of this sort would be the obligation of national treatment⁵³, a norm shared with modern investment treaties. We examine that legal obligation of non-discrimination more fully in the next part.

3. International Investment Agreements

There are approximately 2800 bilateral and regional investment treaties (including investment chapters in free trade agreements) in operation across the globe.⁵⁴ The ability of an investor to successfully initiate and conclude a claim under any part of this extensive network of investment treaties will, however, depend on three key issues.

First, both the claimant and the measure in question must fall within the jurisdiction and scope of operation of the treaty instrument. On this fundamental question, we find a critical difference between U.S investment treaty practice and those of other states. Most U.S investment treaties – including the investment Chapter 11 of the NAFTA – exclude the provision of “subsidies or grants” from the scope of national treatment protection.⁵⁵ In contrast, the investment treaties of other states such as Germany and the U.K contain no such exclusion.⁵⁶ This would, on first view, appear to offer some protection for the U.S against potential complaint by foreign investors for exclusion from the provision of U.S government benefits. It is important however to reiterate that this is only a limited exclusion. It does not prevent claims based on *other* provisions (such as the fair and equitable standard).

A second fundamental issue requires identification of the key substantive obligations of investment treaties that might be breached by the measures surveyed above. We examine this

⁵³ Art. Article XVII of the Japan-US FCNT:

1. Each Party undertakes (a) that enterprises owned or controlled exclusively by its Government, and that monopolies or agencies granted exclusive or special privileges within its territories, shall make their purchases and sales involving either imports or exports affecting the commerce of the other Party solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale: and (b) that the nationals, companies and commerce of such other Party shall be afforded adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases and sales. 2. Each Party shall accord to the nationals, companies and commerce of the other Party fair and equitable treatment, as compared with that accorded to the nationals and commerce of any third country, with respect to: (a) the governmental purchase of supplies, (b) the awarding of concessions and other government contracts, and (e) the sale of any service sold by the Government or by any monopoly or agency granted exclusive or special privileges.

⁵⁴ UNCTAD, Recent Developments in International Investment Agreements, IIA Monitor No. 3 2, 6-7 (2007).

⁵⁵ North American Free Trade Agreement, Dec. 17, 1992, Can-Mex-US, 32 ILM 289 & 605, at Art. 1108(7)(b).

⁵⁶ See, for example, the model German and UK BITs extracted in Campbell McLachlan, Laurence Shore and Matthew Weiniger, International Investment Arbitration: Substantive Principles 2007, at pp. 379-385 and 417-422.

in Parts 3(a) and (b) below and confine our analysis to two key obligations being the requirement that states accord both “national treatment” and “fair and equitable treatment” to foreign investors. Select and larger-scale nationalization of shares in banks may *also* raise issues surrounding investment treaty guarantees of compensation in the event of expropriation.⁵⁷

Finally, there is the issue of whether an exception might apply to shield state conduct from liability under an investment treaty. Some BITs contain carve outs for certain sectors or explicitly allow for prudential regulation of the finance sector. Furthermore, some instruments contain national security clauses which might also be invoked as an exception. We examine these various but limited exceptions in Part 3(c) below.

(a) National Treatment

National treatment proscribes “less favourable treatment” of a foreign investor that stands “in like circumstances” or in “like situations” with a domestic actor.⁵⁸ There are three critical interpretative questions that have occupied arbitral tribunals in interpreting this obligation of non-discrimination. First, when will a foreign investor stand “in like circumstances” or “in like situations” with a domestic actor? A basis for comparison needs to be found and arbitral tribunals have adopted different approaches to identifying relational comparators. Second, what will constitute “less favourable treatment” of a foreign investor? Thirdly and perhaps most critically, is adverse purpose on the part of the regulating state required as a condition of breach and if so, what indicia should be used to evidence or construct such purpose?

As a start point, most of the early cases – including *SD Myers v Canada* (NAFTA, 2000), *Pope & Talbot v Canada* (NAFTA, 2001), *Feldman v Mexico* (NAFTA, 2002); and *ADF v USA* (NAFTA, 2003) – endorse *some* form of competition as a condition of likeness in a national treatment inquiry. Under this line of reasoning, a foreign investor will be “like” a

⁵⁷ On this point, see N. Jansen Calamita, “The British Bank Nationalizations: An International Law Perspective”, 58 ICLQ 2009, pp. 119-149.

⁵⁸ For a review of NT clauses in BITs, see Dolzer, R., & Stevens, M. (1995). *Bilateral Investment Treaties*. The Hague: Nijhoff, pp. 63-65 and for a short survey on the meaning and jurisprudence of NT, see Dolzer, R., & Schreuer, C. (2008). *Principles of International Investment Law*. Oxford: Oxford University Press, p. 178 et seqq. As an example, NAFTA's provision is quoted: Article 1102(2). „Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.” (Article 1102(1) is the same except that it refers to “investors” rather than to “investments of investors;” under Article 1102(3), the obligation applies to state/provincial governments as well.

competing domestic investor. This jurisprudential line is disrupted by the awards in *Occidental v Ecuador* (U.S-Ecuador BIT, 2004) and *Methanex v U.S* (NAFTA, 2005). The *Occidental* Tribunal adopted a much broader approach by ruling that a foreign investor involved in oil exports was “like” domestic companies exporting non-oil related goods such as flowers and seafood products.⁵⁹ The broad *Occidental* test remains largely an outlier in the jurisprudence, with only one later case adopting other parts of that award.⁶⁰ The later *Methanex* Tribunal also opposed a role for competition in a likeness inquiry but offers a much narrower approach requiring identification of an “identical” comparator to the foreign investor.⁶¹ This narrow test also has not found reflection in later case-law, which has largely returned to a competition-based reading of national treatment.⁶²

With this in mind, we expect arbitral tribunals to adopt a robust method that looks to whether foreign investors in the finance sector as a whole are disadvantaged vis-à-vis competing domestic actors. It is unlikely that arbitral tribunals will endorse a narrow view that differentiates between different finance sector actors (such as investment banks, wholesale banks or other investment vehicles) simply on their organizational structure. In any event, certain laws already define the type of financial sector industry⁶³ or the automotive sector qualifying as potential institutions for supporting measures. In those cases, foreign investors falling within the definition (but not included because of their nationality and/or judicial organization), will have a strong claim for inclusion. The more difficult cases involve narrowly tailored definitions such as the Swiss measure targeting only banks that pose a systemic risk to the Swiss economy. Even here, other financial institutions can make credible claims for a broad basis for comparison, since as we have seen, arbitral tribunals have looked to competitive interactions as a necessary condition of finding that domestic and foreign investors operate “in like circumstances”.

The second fundamental interpretative issue involves the determination of “less favourable treatment” of foreign investors and their investments. There is broad consensus that not only *de iure* (in law) discrimination but also *de facto* (in fact) discrimination amounts to a breach

⁵⁹ *Occidental Exploration and Production Company v. Ecuador*, Award, LCIA Case No UN 3467, IIC 202 (2004), signed 01 July 2004, para. 173

⁶⁰ *Siemens A.G. v Argentina*, ICSID Case No. ARB/02/8, Award (6 Feb. 2007), at paras 320-1.

⁶¹ *Methanex Corporation v USA*, UNCITRAL, Final Award (3 Aug. 2008), at Part IV, Chp B, para 17.

⁶² *Corn Products International, Inc. v Mexico*, ICSID Case No. ARB(AF)/04/01, Decision on Responsibility (15 Jan. 2008), at paras. 120-122.

⁶³ E.g. Sec. 2 of the German Financial Market Stabilization Act.

of the national treatment guarantee. This is in line with WTO jurisprudence⁶⁴ and also with most constitutional interpretation in different states. The NAFTA Tribunal in *Feldman v Mexico* ruled clearly that “de facto difference in treatment is sufficient to establish a denial of national treatment under Article 1102.”⁶⁵ In other words, origin-neutral measures that pose a greater adverse burden on the foreign investor than “like” domestic investors may be in breach of the national treatment obligation.

There are various examples of *de iure* discrimination in the measures surveyed above, not least the new Australian and Irish guarantees of retail and/or wholesale deposits that are explicitly limited to domestic institutions. In cases involving origin-neutral measures, there is the difficult issue of determining what level of less favourable treatment of domestic investors is an appropriate requirement of breach. One possibility is that national treatment entitles a foreign investor to the best treatment afforded to “like” domestic investors. Provided that there is a single “like” domestic actor who is treated more favourably by the regulating state, there will be “less favourable treatment” of the foreign claimant. Under this broad approach, it is irrelevant that there may be other “like” domestic actors who are treated equally to, or indeed worse than, the foreign claimant. This broad approach has found reflection in the jurisprudence, most notably in *Pope & Talbot v Canada* (NAFTA, 2001).⁶⁶ It has also been affirmed in successive cases, including *Methanex v U.S* (NAFTA, 2005)⁶⁷, parts of *UPS v Canada* (NAFTA, 2007)⁶⁸ and most recently, *ADM v Mexico* (NAFTA, 2007)⁶⁹. If this test were to be applied, many if not all of the origin-neutral measures surveyed above are likely to constitute “less favourable treatment” of a foreign claimant. Significant competitive advantages flow to domestic banks and institutions from these measures.. That may either stem from much lower refinancing costs through guarantees, recapitalization or liquidity

⁶⁴ See Horn, H., & Mavroidis, P., Still Hazy after All These Years: The Interpretation of National Treatment in the GATT/WTO Case-law on Tax Discrimination. 15 *European Journal of International Law* 2004, pp. 39-69 as well as Cottier, T., & Oesch, M. (2005). *International Trade Regulation: Law and Policy in the WTO, the European Union and Switzerland*, Bern: Stämpfli, p. 383.

⁶⁵ *Feldman*, supra note , para. 169.

⁶⁶ *Pope & Talbot v Canada*, supra note 46, at paras 39-42.

⁶⁷ *Methanex v U.S*, supra note 61, at paras 20-1.

⁶⁸ Arbitrator Cass ruled in his Separate Statement: “It is, as UPS urges, enough to establish that a NAFTA Party has given one or more of its investors or investments more favorable treatment.” *United Postal Service of America Inc. v Canada*, ICSID, Award on the Merits (24 May 2007), Separate Opinion of Arbitrator Cass, at para 60.

⁶⁹ *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v Mexico*, ICSID Case No. ARB(AF)/04/05, Award, at para 205.

support, and allowing supported banks to offer better interest rates than those which still compete normally.⁷⁰

There is a possibility that an arbitral tribunal ruling on an investment treaty other than the NAFTA might adopt a different approach to the identification of “less favourable treatment”. The jurisprudential sequence explored above has its origins in the particular phrasing of the national treatment obligation in NAFTA, and especially NAFTA Article 1102(3)⁷¹. With that in mind, there may be scope in non-NAFTA cases to go beyond the presence of a single most favoured “like” domestic actor. An alternate approach would see the arbitral tribunal compare and evaluate the manner in which the burden of the origin-neutral measure falls on the overall class of domestic investors who stand “in like circumstances” with foreign investors (including the claimant) in the host state. In particular, this would enable an adjudicator to identify and compare favoured and disfavoured impacts across *both* domestic and foreign actors. This group or aggregate approach to identifying “less favourable treatment” has a provenance in WTO law⁷² and was partially endorsed in the *ADF v USA* award⁷³. On the whole though, we expect it likely that an arbitral tribunal will adopt the traditional and more stringent test.

Our third and final interpretative issue concerns the role (if any) of protectionist purpose in assessing breach of national treatment. Some tribunals have held that discriminatory intent is not a necessary element for the breach of national treatment. Following the *Occidental* award⁷⁴, the *Siemens v. Argentina* Tribunal (Germany-Argentina BIT, 2007) held that “intent is not decisive or essential for a finding of discrimination, and that the impact of the measure on the investment would be the determining factor to ascertain whether it had resulted in non-

⁷⁰ The perceived security of state guaranteed banks or bank bonds it mirrored in the spread of Credit Default Swaps, which diminished considerably for those institutions getting help, see only Cash, *Gesicherte Bankanleihen bieten attraktive Renditen* of 14th May 2009, available at: http://www.cash.ch/news/newsletter/gesicherte_bankanleihen_bieten_attraktive_renditen-795407-440. See also Stijn Claessens, *The Financial Crisis and Financial Nationalism*, p. 6.

⁷¹ NAFTA Article 1102(3) provides: “The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that state or province to investors and investments of investors, of the Party of which it forms a part.”

⁷² *European Communities – Measures Affecting Asbestos and Asbestos Containing Products*, W/DS135/AB/R, Report of the Appellate Body (12 March 2001), at para 100.

⁷³ *ADF Group Inc. v USA*, ICSID Case No. ARB(AF)/00/1, Award (9 Jan. 2003), at para 157.

⁷⁴ E.g. *Occidental*, supra note, para. 177: „In the present dispute the fact is that OEPIC has received treatment less favorable than that accorded to national companies. The Tribunal is convinced that this has not been done with the intent of discriminating against foreign-owned companies. [...] However, the result of the policy enacted and the interpretation followed by the SRI in fact has been a less favorable treatment of OEPIC.“

discriminatory treatment.”⁷⁵ Similarly, the *Thunderbird v. Mexico* Tribunal (NAFTA, 2006)⁷⁶ did not require the claimant to show that the less favorable treatment was motivated by nationality.⁷⁷ Under this effects-based approach, the mere presence of less favourable treatment of a foreign investor will be sufficient for breach. For example, the subsidies for the ‘Big Three’ automakers in the US - which *de facto* excludes non-American car producers (except for one Toyota plant in California) – would breach the national treatment obligation of an operative investment treaty.⁷⁸ –

Other awards adopt a very different approach to this interpretative question. These tribunals have explored – with different emphases - whether the distinction is based on legitimate policy grounds and justifiable or solely as a means of conferring protection to domestic actors and thus impermissible. For example, the 2000 NAFTA *Pope & Talbot* Tribunal strongly endorses competition as a necessary condition of likeness in a national treatment inquiry⁷⁹ but also requires evidence of protectionist purpose as a condition of breach⁸⁰. Under this competing approach, differentiation between foreign and domestic actors is permissible if rational grounds are shown for it. This may have particular relevance for interventions such as the Swiss bail-out of Credit Suisse and UBS which were publicly justified on systemic grounds. The problem however is that the investor-state arbitral tribunals have not clearly defined what will constitute a “rational” ground for differentiation. . The 2004 NAFTA *GAMI* Tribunal found that the Mexican measure - nationalization of potentially insolvent sugar refiners - did not breach national treatment because it was motivated by a legitimate public policy goal, namely keeping the sugar industry in the hands of solvent enterprises. .⁸¹ . But in the *Saluka* award, the Tribunal looked at a range of different criteria in assessing the legitimacy of the exclusion of a bank with foreign shareholding from a program of state

⁷⁵ *Siemens AG v. Argentina*, Award and Separate Opinion, ICSID Case No ARB/02/8, 6 February 2007, para 321.

⁷⁶ *International Thunderbird Gaming Corp. v. Mexico*, Award, NAFTA under UNCITRAL, January 26, 2006.

⁷⁷ *Ibid.*, para. 177: “It is not expected from *Thunderbird* that it show separately that the less favourable treatment was motivated because of nationality. The text of Article 1102 of the NAFTA does not require such showing. Rather, the text contemplates the case where a foreign investor is treated less favourably than a national investor. That case is to be proven by a foreign investor, and, additionally, the reason why there was a less favourable treatment.”

⁷⁸ Of course, the likely complainants in such an action will be German and Japanese investors in the automotive industry in the U.S. However, neither Germany nor Japan has executed modern investment treaty protection with the U.S. As we noted earlier however, both those states have older FCN treaties with the U.S which may be an alternate avenue of complaint. See CSR Report for Congress: U.S.-Japan Economic Relations: Significance, Prospects, and Policy Options, 9 July 2007, p. 20 et seqq., available at: <http://www.fas.org/sgp/crs/row/RL32649.pdf>

⁷⁹ *Pope & Talbot*, supra note 46, at para 78.

⁸⁰ *Ibid.* at para 79 (ruling that difference in treatment must ‘be justified by showing it bears a reasonable relationship to rational policies not motivated by preference of domestic over foreign owned investments’).

⁸¹ *GAMI v. Mexico*, Award, NAFTA under UNCITRAL, 15 November 2004, para. 114.

financial assistance to stabilize the Czech banking system.⁸² The Tribunal surveyed criteria such as the systemic importance of the bank, its business strategy and liquidity positions.⁸³ It held that none of these features provided rational grounds for differentiation with domestic banks that took the benefit of the assistance program. For example, on liquidity, the Tribunal held that it “is not convinced that different liquidity ratios warranted different treatment with regard to the provision of State financial assistance in order to overcome the bad debt problem.”⁸⁴ With this in mind, even those measures adopted formally for reasons of systemic concern may be in risk of breach of the national treatment obligation.

(b) Fair and Equitable Treatment

A violation of FET may be alleged on three grounds. One is discriminatory conduct of the states, the other is the intransparency of some of the measures, the third is the denial of justice through making judicial review too late. We will deal with each in turn citing the relevant measures as described above.

The FET standard has often been held to include protection against discriminatory conduct and measures. The tribunal in *Eureko v. Poland*, e.g. has linked “discriminatory conduct” with a finding of a breach of the fair and equitable standard.⁸⁵ This, however, raises a fundamental interpretative issue that has largely been ignored in the jurisprudence to date. The type of discrimination caught under the FET standard (or the occasional separate BIT guarantee against “arbitrary or discriminatory” measures) must be something different to that covered by national treatment otherwise we face the problem of redundancy. Most recent awards simply and bluntly conflate national treatment and the FET standard, where discrimination is at issue in the latter.⁸⁶ This is an untenable outcome given the need to give separate effect to each treaty provision.

In our view, the type of discrimination caught by national treatment is purposeful protectionism, defined as a desire of a host state to protect a domestic actor vis-à-vis a competing foreign investor. There is then the question of what *other* forms of discrimination

⁸² *Saluka Investments BV v. Czech Republic*, Partial Award, PCA -UNCITRAL Arbitration Rules, 17 March 2006.

⁸³ *Saluka*, para. 327 et seqq.

⁸⁴ *Saluka*, para 345.

⁸⁵ See also Separate Opinion Wälde in *Thunderbird*, supra note 76, para. 103.

⁸⁶ See for example *Siemens*, supra note 60, at paras 318-321 (drawing on NAFTA national treatment jurisprudence in interpreting the treaty prohibition of “arbitrary or discriminatory measures”).

might be caught by the FET standard. Few arbitral awards have examined in this in any detail, given the tendency to conflate national treatment and the FET standard. One possibility is a type of hostile “singling out”; the foreign investor is targeted for disadvantage by the host state simply because of their foreignness (rather than any desire to tilt the competitive scales in favour of a domestic actor). We can trace a concern with this type of hostile discrimination in customary international law (which is incorporated into particular FET standards such as NAFTA Article 1105) together with intriguing hints in this direction in the decision of the ICJ Chamber in *ELSI*⁸⁷. If this is to be the type of discrimination caught by the FET standard, there is little evidence of hostile singling out at play in the measures we have surveyed. To put it bluntly, we are dealing with classic protectionist measures, rather than any desire to harm or evict foreign actors, *per se*.

Transparency of state measures, or regulatory transparency, have been found a prerequisite of non-violation of the fair and equitable treatment standard,⁸⁸ put differently: non-transparency of state action could lead to a violation of said standard.⁸⁹ In *Metalclad*, the tribunal cited the prominence of transparency in the NAFTA treaty for creating a predictable framework for a firm’s business planning and investment.⁹⁰ The *Tecmed* tribunal followed in the requirement of transparency, but based its reasoning on a good faith in international law argument, embedded also in fair and equitable treatment,⁹¹ and was followed by the *Saluka* tribunal. In all of the cases, administrative acts were in question. The emergency measures until now have been enshrined in laws. They have also been published immediately on the governments websites are thus readily available. Nevertheless, there is intransparency on who exactly is entitled to certain measures, mostly so in the US since there is no clarification on what are “substantial business activities” and whether or not foreign branches are included, or what is

⁸⁷ *ELSI*, supra note 51.

⁸⁸ *Metalclad Corp. v. Mexico*, ICSID Case No. ARB(AF)/97/01 See for more details: Akira Kotera, Regulatory Transparency, in: Muchlinski/Ortino/Schreuer, *Oxford Handbook of International Investment Law*, 2008, 617-636.

⁸⁹ The NAFTA Free Trade Commission issued a binding statement in 2001 concerning the interpretation of Fair and Equitable Treatment. See “Free Trade Commission Clarifications Related to NAFTA Chapter 11,” July 31, 2001, at <http://www.ustr.gov/regions/whemisphere/nafta-chapter11.html>. It held that this provision equals only Minimum Standard of Treatment and does not contain any transparency requirements for states. For non NAFTA cases, this is not binding.

⁹⁰ At para. 99. See also para. 76.

⁹¹ *Tecnicas Medioambientales TECMED S.A. v. Mexico*, ICSID CASE No. ARB (AF)/00/2, para. 154: “The Arbitral Tribunal considers that this provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations.”

meant by “government owned”.⁹² But since the laws have to be interpreted by the executive branch, it is too early to say, whether intransparency will continue. Furthermore, if the TECMED reasoning would be followed, one might make the argument that the sudden shift in business environment due to the measures taken would violate basic expectations of foreign investors, since they expected equal competitive conditions for all. Nevertheless, a change in business environment as in times of crises is not encompassed by legitimate expectations and cannot be guaranteed by a state. If there is a change of business environment due to discriminatory emergency measures, this must, in our view, be part of a violation of NT, not of FET, in order not to conflate the standards.

The last potential violation of the FET standard could be imagined in a cutting back of due process standards which is one element of the standard. In Germany⁹³ as well as in the United States,⁹⁴ special procedures have been foreseen in the emergency laws. Both of them restrict the review mechanisms usually available against state actions, but both of them do not entirely exclude judicial review. Since there is no complete denial of due process, it seems that a violation is rather unlikely to be found. Whereas the US law provides for quick decisions by the courts, the German law does not. The latter therefore might entail a de facto denial of review since all decisions might come too late (unless a preliminary injunctions are granted which make also take some time).

(c) Exceptions

There are exceptions for host state conduct in the event of a finding of liability for breach of an obligation in an applicable investment treaty. Given the heterogeneity of this field, there are three possible categories of exemption that might apply depending on the instrument in question. First, certain newer investment treaties – especially those concluded as part of a free trade agreement – offer qualified exemption for prudential regulation of the financial services industry. This type of exemption is modeled on the similar carve-out examined earlier under the WTO General Agreement on Trade in Services). Second, certain states have amended their model bilateral investment treaty to ensure that any invocation of a treaty exemption for, *inter alia*, “essential security interests” is a matter of competence for signatory

⁹² Public Law 110-343, 12 USC 5202, Sec. 3: “Financial institution.--The term ‘financial institution’ means any institution, including, but not limited to, any bank, savings association, credit union, security broker or dealer, or insurance company, established and regulated under the laws of the United States or any State, territory, or possession of the United States, the District of Columbia, [...] and having significant operations in the United States, but excluding any central bank of, or institution owned by, a foreign government.”

⁹³ Sec. 15 and 16 of the Financial Market Stabilization Act.

⁹⁴ 12 USC 5229, Sec. 119.

states alone.⁹⁵ This shift towards auto-interpretation precludes any role for an adjudicator in assessing whether the constituent elements of the treaty exception have in fact been proven. In general, both these categories of exemption are relatively rare and reflect new trends in investment treaty rule-making.

In contrast, older investment treaties will only typically exempt measures “necessary” to maintain “public order” or to protect “essential security interests”.⁹⁶ This form of exemption is not explicitly self-judging and indeed has been adjudicated in a range of cases brought against Argentina in the aftermath of its 2001-2 financial crisis. Particular tribunals have been prepared to find that the adverse societal effects of the Argentine financial crisis could engage that state’s “essential security interests”. We should, however, exhibit some caution in relying on this case-law. Early arbitral awards – including *CMS*, *Enron* and *Sempra* – engage in a questionable interpretative methodology of conflating the terms of the treaty exception with the stringent customary plea of necessity (represented by Article 25 of the International Law Commission’s Articles on the Responsibility of States for Internationally Wrongful Acts).⁹⁷ This approach runs counter to the ILC’s own taxonomy which separates questions of wrongfulness from responsibility at international law.⁹⁸ The customary defence of necessity only becomes operative if we can first identify a wrongful act at international law, which is purely a question for the investment treaty at issue.

This then raises our first interpretative question of whether the effects of financial crisis might somehow engage a state’s “essential security interests”. Of the few cases that have avoided the error of conflating the treaty defence with the customary plea, the *Continental* award offers especially pertinent guidance on this question. That Tribunal was prepared to accept that the grave economic and social dislocations of the Argentine financial crisis were sufficient to engage that state’s “essential security interests”.⁹⁹ Ultimately however, the likely success of this defence may turn more so on whether an adjudicator will find that the particular measures chosen by the state are indeed “necessary” to protect such “essential

⁹⁵ See 2004 U.S. Model BIT, Art. 13, available at http://www.ustr.gov/Trade_Sectors/Investment/Model_BIT/Section_Index.html.

⁹⁶ See eg, Art. XI of 1991 U.S-Argentine BIT.

⁹⁷ For extended analysis on this point, see Jurgen Kurtz, “Adjudging the Exceptional at International Law: Security, Public Order and Financial Crisis”, Jean Monnet Working Paper No 06/08 (2008).

⁹⁸ International Law Commission, Draft Articles on the Responsibility of States for Internationally Wrongful Acts with Commentaries, U.N. GAOR, 56th Sess., Supp. 10, Ch. 4, U.N. Doc. A/56/10 (2001), at Art. 25. See also *ibid.* at pp. 15-18 (examining the historical imperatives for the development of a secondary defence of necessity in the work of the ILC).

⁹⁹ *Continental, Casualty Company v Argentina*, ICSID Case No. ARB/03/9 (5 Sept. 2008), at pp. 78-9.

security interests”. The necessity component of the treaty exception asks a question of the closeness or fit between the chosen means and the asserted regulatory purpose of the state in question. There are various methods of engaging in means-end inquiry, with the *Continental* Tribunal electing to endorse a “reasonable less restrictive means” test.¹⁰⁰ This approach requires an adjudicator to assess whether there any reasonably available alternatives to the chosen measure that have less restrictive effects on the rights of foreign investors. On the whole, it is unlikely that the current measures will fall within the exemption. It will be difficult to make the argument that discrimination directed against foreign bank institutions (with domestic depositors) was indeed “necessary” to protect those “essential security interests”.

Apart from the more general security exceptions, some BITs contain prudential carve outs for the financial services sector, usually modeled on Art. 2 of GATS Annex on Financial Services. Art. 20 of the US Model BIT¹⁰¹ as well as Art. Article 10 para 2 (c) of the Canadian Model BIT¹⁰² have incorporated those. Furthermore, some US BITs contain MFN/NT exceptions for the financial sector.¹⁰³ But neither the Swiss, the German or the UK BITs contain prudential carve outs or MFN/NT exceptions for the financial service sector. If there is a plain exception on NT in the financial services sector, no claims based on NT will be successful, but investors may still consider to claim under FET, and be successful, depending on how FET is interpreted. If there is only a prudential carve-out, all depends how this carve-out is interpreted. Since the GATS prudential carve-out has never been interpreted by a Panel, there is not much clarity expected from there.¹⁰⁴

¹⁰⁰ Ibid. at pp. 87-8.

¹⁰¹ The US-Uruguay BIT of 2006 contains a prudential carve-out in Art. 20 (1): “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 [...]”

¹⁰² Canadian 2004 Model Foreign Investment Protection and Promotion Agreement (FIPA), Article 10 (2), available at <http://www.sice.oas.org/Investment/NatLeg/Can/2004-FIPAmoel-en.pdf> (accessed 7 May 2009): “2. Nothing in this Agreement shall be construed to prevent a Party from adopting or maintaining reasonable measures for prudential reasons, such as: (a) the protection of investors, depositors, financial market participants, policyholders, policy-claimants, or persons to whom a fiduciary duty is owed by a financial institution; (b) the maintenance of the safety, soundness, integrity or financial responsibility of financial institutions; and (c) ensuring the integrity and stability of a Party’s financial system.” Similar Art. 25 of the 2007 Norwegian Model BIT, Draft Norwegian Model BIT, available at <http://www.regjeringen.no/upload/NHD/Vedlegg/hoeringer/Utkast%20til%20modellavtale2.doc> (accessed 7 May 2009)

¹⁰³ The Argentinian-US BIT of 1994 contain exceptions of NT, Protocol to the BIT: (2) With reference to Article II, paragraph 1, the United States reserves the right to make or maintain limited exceptions to national treatment in the following sectors: [...] banking; insurance [...]”. The US-Bulgaria BIT of 1994 and the US-Turkey BIT of 1990 contain similar clauses. The Ukraine-US BIT Ukraine of 1996 does exclude financial services from MFN/NT: “The U.S. portion of the Annex contains a list of sectors and matters in which, for legal and historical reasons, the federal government or the States may not necessarily treat investments of nationals or companies of the other Party as they do U.S. investments or investments from a third country. The U.S. exceptions from national treatment are: [...] banking; insurance [...]”

¹⁰⁴ Mamiko Yokoi-Arai, GATS' Prudential Carve Out in Financial Services and Its Relation with Prudential Regulation, 57 *International and Comparative Law Quarterly* 2008, pp. 613-648.

One should keep in mind that in most IIAs contain a most favored national clause (MFN), that is, even if the IIA in question is more restrictive, an investor may still invoke a potentially more favorable clauses in other IIAs ratified by the host state through the MFN Clause of the IIA he is covered by. The carve-out, if used to shield the host state from suits concerning measures in the financial sector, might therefore be rendered obsolete.

V. Conclusion and Outlook

We draw two tentative and sobering conclusions from this analysis. First, there is clear evidence of both overt and factual discrimination directed at foreign actors (and goods) in the laws we have surveyed. This is not confined to any individual state or select grouping; it is a marked characteristic of emergency responses to the financial crisis across a significant proportion of the globe. This then is a timely reminder to revisit the lessons associated with the outbreak of protectionism leading to the Great Depression in the inter-war period, exactly eighty years ago. Protectionism is the result of a prisoner's dilemma understood in game theory terms. Cooperation would make every state better off, but it is individually rational for states to pursue their self-interest (and protect domestic industry) at least in the short run. While protectionist instincts are now more nuanced, it is difficult to escape the conclusion that states are failing to cooperate in the current crisis, with possible cascading consequences. One pertinent example is the sharp contraction in credit availability across Eastern Europe, where much of the banking sector is controlled by Western European banks who now have strong incentives to lend only within their home countries. This leads to our second, tentative assessment. The framers of the post-Second World War architecture of international law (especially the GATT, the forerunner of the WTO), were deeply influenced by the lessons of the inter-war period. They had drafted those rules hoping to embed a loose form of cooperation and constrain the freedom of states to resort to short-term protectionist measures. The preparedness and rapidity by which states are now moving in that direction raise serious questions of whether our existing system is in fact a sufficient check against these problematic and destructive tendencies.

Ultimately however, these complex issues may be addressed – at least in the short-term - in legal rather than diplomatic *fora*. The 2001 Argentine financial crisis triggered a wave of international investment litigation against that state. There is good reason to expect foreign

investors will similarly seek to use their rights under international investment law to combat discrimination embodied in state responses to the current crisis. The prospect of success of such litigation – with the possibility of award of significant monetary compensation - should act as a constraint against risk-adverse governments continuing to resort to short-term protectionist measures.

Table 1: Summary of Legal Instruments and Success of Legal Action

Legal Instruments	Features				
	State to State Dispute Settlement	Investor to State Dispute Settlement	Specific Exceptions	General Exceptions (such as security)	Likelihood of successful action, judged by substantive law
Trade Law					
GATS	WTO	---	Prudential Carve-Out for Financial Services		-
SCM Agreement	WTO	---	---	---	+
Investment Law					
OECD National Treatment	---	---	Notification requirement (none for the measures taken)	---	-
FCN Treaties	ICJ	---			+
BITs and NAFTA (Investment)	ICSID; UNICTRAL	ICSID; UNICTRAL	Some (US, Can for Financial Services)	Some (US, Can: newer BITs self-judging)	+