Chapter 5.1.3

Defenses by the Host State

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A. INTRODUCTION

A respondent host state in investment arbitration enjoys a variety of defence arguments to avoid being held liable vis-à-vis the claimant investor. These may include challenges to the tribunal's jurisdiction, reliance on treaty carve-outs or exception clauses, the abuse of right doctrine, necessity, or even submissions on claimant's contributory fault. Accordingly, defence arguments may operate at different levels and entail different consequences, which complicates their classification. However, the division of defence arguments between defences operating at the level of primary norms and defences operating at the level of secondary norms conceived by Jorge E. Viñuales seems illustrative.[1] This is based on the differentiation between primary rules (rules imposing obligations on states), and secondary rules (rules on the consequences for failing to fulfil the primary rules also known as rules on responsibility), drawn up by Roberto Ago, special rapporteur to the International Law Commission (ILC).[2] Consequently, while defences at the level of primary norms seek to disprove the wrongfulness of the particular conduct, defences at the level of secondary norms strive to justify an existing breach, thereby precluding the respondent's responsibility. This classification may nevertheless not encompass all types of defence arguments available in investment arbitration.

Against this backdrop and with the aim of providing an overview of the most common defence arguments used by host states in investment arbitration, this contribution addresses, in its first and second sections, defences operating at the level of primary norms [B], and defences operating at the level of secondary norms [C]. The third section explores the defences based on treaty exception clauses given their controversial nature [D]. The fourth section elaborates on some additional arguments used as 'defences' by host states which intend neither to preclude wrongfulness nor responsibility [E]. Finally, some conclusions are presented [F].

B. DEFENCES AT THE LEVEL OF PRIMARY NORMS

Defence arguments at the level of primary norms seek to avoid the finding of a breach of a sState's obligation under the particular investment treaty. There are four kinds of arguments a respondent may submit: the tribunal does not have jurisdiction [I], specific limitations in the underlying treaty prevent the tribunal from adjudicating the case [II], the investor is deprived from reliance on the treaty [III], and there is no breach [IV].

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1 Viñuales, *Defence Arguments in Investment Arbitration,* in Viñuales and Waibel (eds.), *ICSID Reports: Volume 18* (2020), pp. 9-108, para. 8.

2 ILC, *Second Report on State Responsibility*, by Mr. Roberto Ago, Special Rapporteur, *The Origin of International Responsibility* (20 April 1970) UN Doc. A/CN.4/233, para. 11: ("[i]n its previous drafts, the Commission has generally concentrated on defining the rules of international law which, in one sector of inter-State relations or another, impose particular obligations on States, and which may, in a certain sense, be termed 'primary', as opposed to other rules - precisely those covering the field of responsibility - which may be termed 'secondary', inasmuch as they are concerned with determining the consequences of failure to fulfil obligations established by the primary rules").

I. The Tribunal's Lack of Jurisdiction

Without prejudice to other contributions in this book,[3] a tribunal's jurisdiction is framed by five dimensions: i) consent, ii) covered investor or requisite *ratione personae*, iii) covered investment or requisite *ratione materiae*, iv) the treaty's temporal scope of application or requisite *ratione temporis*, and v) additional requirements a treaty may impose.

By contesting the tribunal's jurisdiction, a respondent state may prevent the assessment of the breach, thus avoiding any consideration of the particular conduct and the obligations at stake.

The **consent** of the disputing parties is the cornerstone of a tribunal's jurisdiction. Thus, a defence for the respondent might be disproving its consent to submit to arbitration. A state may express its consent through a contract clause, domestic legislation, or an international treaty.[4] In the case of contract clauses, the investor might express its consent concomitantly with the state. In the case of domestic legislation and treaties, the investor usually expresses its consent through the submission of a notice of arbitration. The state may argue that a treaty was not ratified, that the state has given notice or is otherwise no longer bound by the treaty,[5] that the treaty does not contain a valid consent to arbitration,[6] or that the state made valid reservations against certain parts of the treaty.[7]

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3 See, in particular, *Chapter 5.1.1: Initiation of Arbitration Proceedings*, by Afolabi Adekemi, in this volume.

4 Van Harten, *Investment Treaty Arbitration and Public Law* (2007) 24; Kriebaum, *The Nature of Investment Disciplines,* in Douglas, Pauwelyn and Viñuales (eds), *The Foundations of International Investment Law* (2014), p. 69; Schreuer, *Investment Arbitration,* in Romano, Alter and Shany (eds), *The Oxford Handbook of International Adjudication* (2014), pp. 295-315 (302-303).

5 In theory, a state may argue that it is no longer bound by the treaty due to lawful termination, withdrawal, or suspension of the treaty based on one of the following grounds: (i) Provisions within the Treaty (Article 54 VCLT): The treaty itself provides for termination or withdrawal, and the state has complied with those provisions; (ii) Consent of the Parties (Article 54 VCLT): All parties to the treaty have consented to terminate or suspend the treaty; (iii) Material Breach (Article 60 VCLT): Another party to the treaty has materially breached the treaty, allowing the state to suspend or terminate its obligations; (iv) Supervening Impossibility of Performance (Article 61 VCLT): An unforeseen event has made the performance of the treaty impossible; and Fundamental Change of Circumstances (Article 62 VCLT): There has been a fundamental change of circumstances since the treaty was concluded, which was not foreseen by the parties and which fundamentally changes the extent of obligations still to be performed.

In practice, most investment protection treaties provide investor protection for ten to twenty years beyond an effective termination of the treaty; see, e.g., Art. 14(2) of the 2010 BIT between Switzerland and Egypt, available at https://investmentpolicy.unctad.org/international-investment-agreements/countries/203/switzerland.

6 Consent could be invalid because of error (Art. 48 Vienna Convention on the Law of Treaties, VCLT), fraud (Art. 49 VCLT), corruption (Art. 50 VCLT), or coercion (Arts. 51 and 52 VCLT). In certain cases, a state may argue that consent was given *ultra vires* (Art. 46 VCLT), i.e. that it was given in violation of a provision of internal law of fundamental importance regarding competence to conclude treaties, and this violation was manifest and objectively evident to any state conducting itself in the matter in accordance with normal practice and in good faith. Last but not least, although unlikely in case of investment treaties, a treaty could be void because it conflicts with a peremptory norm of general international law (jus cogens) at the time of its conclusion, or a new jus cogens norm has emerged which voids the treaty (Arts. 53 and 64 VCLT).

7 Under certain conditions, a state can argue that it is not bound by certain provisions of a treaty if it made a reservation or otherwise carved out those obligations, see below, B.II. The Vienna Convention on the Law of Treaties (VCLT) provides the primary legal framework for reservations. Pursuant to Art. 14 VCLT, a state

With respect to **covered investor** and **covered investment**, a respondent host state may argue that either the investor or the investment does not fulfil the treaty requirements to be protected. Investment protection under international investment agreements (IIAs) is reserved for investors that meet the definition of 'investor' under the respective IIA. Such definitions typically use the criteria of nationality for natural persons[8] and of incorporation or center of activities for juridical legal persons.[9] Similarly, the definition of 'investment' must be fulfilled. Whilst some arbitral tribunals consider that complying with the treaty definition of investment is sufficient for jurisdictional purposes,[10] other tribunals have supported an 'objective' approach, whereby an investment must fulfil certain requirements irrespective of the underlying treaty.[11] These requirements are i) contribution, ii) duration, and iii) risk.[12] Some tribunals have considered additional requirements including a contribution to the host state's development,[13] however this has not been broadly endorsed.

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may formulate a reservation unless the reservation is prohibited by the treaty, the treaty provides that only specified reservations, which do not include the reservation in question, may be made, or the reservation is incompatible with the object and purpose of the treaty. Based on Arts. 20 and 21 VCLT, if the treaty explicitly allows reservations, other parties to the treaty must accept the reservation for it to be valid. Acceptance by other parties is presumed unless they object within a specified time frame. If no objections are raised within 12 months of notification or by the time the treaty enters into force, whichever is later, the reservation is considered accepted.

A valid reservation modifies the provisions of the treaty to the extent of the reservation for the reserving state in its relations with other states parties. If another party objects to the reservation, the provisions to which the reservation relates do not apply between the reserving state and the objecting state to the extent of the reservation.

In multilateral treaties, reservations that do not contradict the object and purpose of the treaty are generally more acceptable than in bilateral treaties.

8 See on this, *UNCTAD, Scope and Definition: UNCTAD Series on Issues in International Investment Agreements II*, UNCTAD/DIAE/IA/2010/2 (2011), p. 73; https://unctad.org/system/files/official-document/diaeia20102_en.pdf.

9 ILA German Branch, Sub-Committee on Investment Law (Working Group), *The Determination of the Nationality of Investors under Investment Protection Treaties - A Preliminary Report* (2009), 69 Inst. Econ. L., Martin Luther Univ. Halle-Wittenberg 14.

10 See e.g., *Abaclat and others (formerly Giovanna a Beccara and others) v. Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility (4 August 2011), para. 364; *SGS Société Générale de Surveillance S.A. v. Republic of Paraguay*, ICSID Case No. ARB/07/29, Decision on Jurisdiction (12 February 2010) paras. 93-96; *Garanti Koza LLP v. Turkmenistan*, ICSID Case No. ARB/11/20, Award (19 December 2016) paras. 235-242.

11 See, for instance, Timmer, *The Meaning of "Investment" as a Requirement for Jurisdiction Ratione Materiae of the ICSID Centre* (2012) 29 (4) J. Int'l Arb., pp. 363-373; See also, Reinisch, *Putting the Pieces Together ... an EU-Model BIT* (2014) 15 JWIT, pp. 679-704 (685ff).

12 See e.g., *Saba Fakes v. Republic of Turkey*, ICSID Case No. ARB/07/20, Award (14 July 2010), paras. 108-110; *Quiborax S.A., Non-Metallic Minerals S.A. and Allan Fosk Kaplún v. Plurinational State of Bolivia*, ICSID Case No. ARB/06/2, Decision on Jurisdiction (27 September 2012), para. 211.

13 See e.g., *Salini Costruttori S.P.A. and Italstrade S.P.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction (16 July 2001), para. 52; *Jan de Nul N.V. and Dredging International N.V. v. Arab Republic of Egypt*, ICSID Case No. ARB/04/13, Decision on Jurisdiction (16 June 2006), paras. 91-92.

In addition, respondent host states might bring as a defence argument the *illegality* of the investment. The issue of illegality is addressed at length elsewhere in this book.[14] Thus, this part will focus only on the relevant aspects for a defence argument. An investor may engage in illegal conduct when making the investment or during its operation.[15] Whilst the former constitutes a jurisdictional barrier, the latter may be assessed by the tribunal as part of the merits of the case.[16] With respect to the legality of the investment as a jurisdictional requirement, one must differentiate between treaties imposing an obligation of compliance with domestic laws and treaties without such an obligation.[17]

For instance, Article 1 of the Germany-Philippines bilateral investment treaty (BIT) of 1997 provides that '[f]or the purpose of the Agreement, the term "investment" shall mean any kind of asset accepted in accordance with the respective laws and regulations of either Contracting State.' This provision was construed by the *Fraport* tribunal as part of the requirement of *ratione materiae* jurisdiction, and thus a barrier to illegal investments being protected under the BIT.[18] However, not every breach of domestic law may result in a lack of jurisdiction of an ISDS tribunal. In this regard, the *Kim* tribunal held that a case-by-case analysis is required 'examining both the seriousness of the investor's conduct and the significance of the obligation not complied with so as to ensure that the harshness of the sanction of placing the investment outside of the protections of the BIT is a proportionate consequence for the violation examined.'[19]

The treaty's **temporal scope of application** (or *ratione temporis*) constitutes another requirement for the tribunal's jurisdiction. The issue is relevant in two cases: acts or disputes occurring before the treaty's entry into force, on the one hand, and statutes of limitation, on the other hand.[20] With respect to the former, in the absence of specific treaty provisions providing otherwise, a tribunal generally has no jurisdiction over acts occurring before the treaty's entry into force.[21] With respect

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14 See *Chapter 3.2: Legality Requirements and Corruption in Investment Arbitration*, in this volume.

15 Kriebaum, *Investment Arbitration - Illegal Investments*, in Welser et al. (eds), *Austrian Yearbook on International Arbitration* (2010), pp. 307-335 (329).

16 Illegality of an investment emerging only during its operation may reduce the quantum of compensation owed to the investor, see below [E].

17 Absent a treaty provision imposing compliance of an investment with domestic law, the 'clean hands' doctrine has been developed to determine whether investors involved in illegal activities can rely on protections provided by a particular treaty, see below [B][II][2].

18 *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines*, ICSID Case No. ARB/03/25, Award (16 August 2007), paras 396 ff.

19 *Vladislav Kim and others v. Republic of Uzbekistan*, ICSID Case No. ARB/13/6, Decision on Jurisdiction (8 March 2017), para. 404. Similarly, *Cortec Mining Kenya Limited, Cortec (Pty) Limited and Stirling Capital Limited v. Republic of Kenya*, ICSID Case No. ARB/15/29, Award (22 October 2018), para. 320: ('The Tribunal endorses the application of the Kim principle of proportionality to an assessment of the impact of alleged illegalities. Omission of a minor regulatory requirement, such as the act of Mr. Langwen on 8 July 2013 to issue an ordinary letter rather than use Form 3 of Schedule 1 of the Environmental (Impact Assessment and Audit) Regulations, or inadvertent misstatements, will not have the same impact as an investment "created" in defiance of an important statutory prohibition imposed in the public interest').

20 See on this, Rubins and Love, *Ratione Temporis*, in Bungenberg et al. (eds), *International Investment Law: A Handbook* (2015), pp. 481-494.

21 *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2, Award (11 October

to the latter, a claim may be barred from jurisdiction if it is not submitted in time.[22] Consequently, a respondent state may argue that the conduct in question occurred before the treaty entered into force or that the claim is belated, thereby challenging the tribunal's jurisdiction over the particular claim.

Finally, **additional requirements** for commencing arbitration range from cooling-off periods,[23] engagement in consultations between the disputing parties, or the submission of a notice of intent.[24] Should an IIA impose such requirements, the investor must abide by them before submitting to arbitration.[25] Failure to comply with these kind of requirements could be raised by a respondent host state as a defence, challenging the tribunal's jurisdiction.

II. Specific Limitations

Specific limitations in the underlying IIA may provide another layer of defence arguments for the respondent host state, which, if applicable, might prevent the tribunal from entertaining the substance of the investor's claim. There are two kinds of specific limitations. First, treaty provisions that exclude certain persons, objects or matters from the general applicability of the treaty, also known as reservations, exemptions and carve-outs [1]. Second, treaty provisions that grant to the state the power to enact certain measures without engaging the state's liability, also known as non-precluded measures (NPM) [2].

1. Reservations, Exemptions and Carve-outs

The general applicability of an IIA may be restricted by treaty reservations, exemptions and carve-outs. **Reservations** under public international law are unilateral statements of a state when signing, acceding or ratifying a treaty, which intend to modify or exclude the legal effect of certain provisions.[26] According to Articles 19 and 20 of the Vienna Convention on the Law of Treaties (VCLT), a reservation may require the acceptance of other contracting states or may be subject to their objections; a reservation may also be prohibited if it is incompatible with the treaty's object and purpose, or by the treaty's explicit text. Insofar as a reservation is validly incorporated and the

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2002), para. 68; *Generation Ukraine, Inc. v. Ukraine*, ICSID Case No. ARB/00/9, Award (16 September 2003), para. 11.2; *Pac Rim Cayman LLC v. Republic of El Salvador*, ICSID Case No. ARB/09/12, Decision on Jurisdiction (1 June 2012), para. 2.103.

22 For a full analysis on statutes of limitation see, Alvarado-Garzón, *Compensation with a Chess Clock? The Interaction of Statutes of Limitation with the Calculation of Damages in Investment Arbitration*, in Sachs, Johnson and Coleman (eds), *Yearbook on International Investment Law & Policy 2019* (2021), pp. 405-424 (paras. 21.05 ff).

23 On this see e.g., Baltag, *Not Hot Enough: Cooling-Off Periods and the Recent Developments under the Energy Charter Treaty* (2017) VI(1) Indian J. Arb. L., pp. 190-196.

24 E.g., under NAFTA, Art 1119, an investor had to deliver a written notice of intent to submit a claim to arbitration at least 90 days in advance, specifying '(a) the name and address of the disputing investor and, where a claim is made under Art. 1117, the name and address of the enterprise; (b) the provisions of this Agreement alleged to have been breached and any other relevant provisions; (c) the issues and the factual basis for the claim; and (d) the relief sought and the approximate amount of damages claimed.'

25 Bjorklund, *Contract without Privity: Sovereign Offer and Investor Acceptance* (2001) 2(1) Chi. J. Int'l L., pp. 183-192 (190).

26 Walter, in Dörr and Schmalenbach (eds), *Vienna Convention on the Law of Treaties: A Commentary* (2018), Art. 19, mn. 1 ff.

particular matter falls within the scope of such reservation, a respondent host state may invoke it to prevent the tribunal from entertaining such matter.

Conversely, carve-outs or exemptions are treaty clauses agreed by the contracting parties that relate to measures, persons or objects that would normally be covered by the treaty's scope of application but that the contracting parties decided to exclude from the scope of one or more specific provisions.[27] The most common carve-outs concern taxation measures and public procurement. For instance, Article 1108(7)(a) of the North American Free Trade Agreement (NAFTA) excluded the applicability of the provisions on national treatment, most-favored nation treatment, and senior management and boards of directors, for public procurement-related measures. This provision constituted a carve-out, whose function was to exclude procurement activities from the scope of some standards of protection under NAFTA.[28] For instance, the *Mercer* tribunal dismissed claims for the violation of national treatment and most-favored nation treatment, but accepted jurisdiction for the violation of the minimum standard of treatment, since the latter was not covered by the NAFTA public procurement carve-out.[29]

An example of a taxation carve-out is Article 21 of the Energy Charter Treaty (ECT), which restricts the availability of standards of protection, under certain conditions, i.e., for particular taxation measures. As held by the *Antaris* tribunal, if a measure is considered a 'taxation measure' in accordance with Article 21 ECT, a tribunal would lack jurisdiction to entertain a claim over such measure.[30] In its assessment, the tribunal is required to analyze the characterization of the measure in question under domestic law, but consideration of the substance ought to prevail over the form.[31] Consequently, depending on the underlying IIA, carve-outs or exemptions may constitute defence arguments for the respondent host state to prevent the particular matter from being scrutinized by the arbitral tribunal.

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27 Viñuales, *Seven Ways of Escaping a Rule: Of Exceptions and their Avatars in International Law*, in Bartels and Paddeu (eds), *Exceptions in International Law* (2020), pp. 65-87 (67).

28 *Mesa Power Group, LLC v. Government of Canada*, UNCITRAL, PCA Case No. 2012-17, Award (24 March 2016), para. 427. For general discussion see *Chapter 4.8: A Closer Look at NAFTA and the USMCA*, by April Barnard, in this volume.

29 *Mercer International Inc. v. Government of Canada*, ICSID Case No. ARB(AF)/12/3, Award (6 March 2018), paras. 6.50-6.51.

30 *Antaris Solar GmbH and Dr. Michael Göde v. Czech Republic*, PCA Case No. 2014-01, Award (2 May 2018), para. 217.

31 *Antaris Solar GmbH and Dr. Michael Göde v. Czech Republic*, PCA Case No. 2014-01, Award (2 May 2018), paras. 224 and 229. In a prior decision, the *Yukos v Russia* tribunal considered whether the specific measure was motivated by the purpose of raising revenue for the state versus being a measure intended to punish or deprive an investor, as a way of giving priority to the substance over the form of a measure, see *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, UNCITRAL, PCA Case No. 2005-04/AA227, Award (18 July 2014), paras. 1430-1431. However, an inquiry into the real vs. alleged purposes of a measure might cause an arbitration procedure to become too fact-intensive and volatile, see Viñuales, *Defence Arguments in Investment Arbitration*, in Viñuales and Waibel (eds), *ICSID Reports: Volume 18* (2020), pp. 9-108, para. 24.

2. Non-Precluded Measures or Security 'Exceptions'

NPM clauses have migrated from Friendship, Commerce and Navigation (FCN) treaties to IIAs, including the first BIT between Germany and Pakistan of 1959, and currently play a major role, especially with respect to investments in the financial sector.[32] They are an expression of the right to regulate since they enable the state to adopt certain measures to protect public interests even if they should otherwise be inconsistent with substantive standards of protection under the treaty.[33] As such, NPM clauses have a risk-allocation function because the costs of harming the investment are transferred from the host state to the investor.[34] Of course, the precise language of NPM clauses will vary across different IIAs[35] and, in some cases, they may even be labeled as 'public security exceptions.'[36] For instance, while Article XI of the Argentina-US BIT of 1991 broadly permits measures for the maintenance of public order, restoration of international peace or security, and for the protection of essential security interests, Article 11(3) of the India-Mauritius BIT of 1998 explicitly refers to the protection of public health or the prevention of diseases in pests and animals or plants. The operation of these clauses seems rather straightforward: if a measure is adopted in pursuance of one of the public interests defined in the particular NPM clause, also known as the 'nexus' requirement, it cannot be used to substantiate a treaty violation by the host state.[37]

As held by the *Continental* tribunal, the applicability of an NPM clause excludes the possibility of a treaty breach since the measure in question would lie outside the scope of the treaty.[38] Similarly, the *CC Devas* tribunal found that certain restrictions on the electro-magnetic spectrum pertain to an essential security interest, triggering the NPM clause, thus precluding the tribunal from its adjudicatory power in that regard.[39] Admittedly, the interpretation of these clauses has been controversial,[40] particularly on three issues: first, the standard of review; second, the relation

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32 Burke-White and von Staden, *Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties* (2008) 48(2) Va. J. Int'l L., pp. 307-409 (312-313).

33 Wang, *The Non-Precluded Measure Type Clause in International Investment Agreements: Significances, Challenges, and Reactions* (2017) 32(2) ICSID Rev.-FILJ, pp. 447-456 (447).

34 Burke-White and von Staden, *Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties* (2008) 48(2) Va. J. Int'l L., pp. 307-409 (314).

35 Rose-Ackerman and Billa, *Treaties and National Security* (2008) 40(2) NYU JILP, pp. 437-496 (451 ff); Van Vaerenbergh and Hazarika, *Climate Change as a Security Risk: Too Hot to Handle?* (2020) 54(3) JWT, pp. 417-438 (426).

36 See, for instance, Vandevelde, *Rebalancing through Exceptions* (2013) 17(2) Lewis & Clark L. Rev., pp. 449-460 (449 ff); Legum and Petculescu, *GATT Article XX and International Investment Law,* in Echandi and Sauvé (eds), *Prospects in International Investment Law and Policy* (2013), pp. 340-362 (348).

37 Wang, *The Non-Precluded Measure Type Clause in International Investment Agreements: Significances, Challenges, and Reactions* (2017) 32(2) ICSID Rev.-FILJ, pp. 447-456 (448).

38 *Continental Casualty Company v. The Argentine Republic*, ICSID Case No. ARB/03/9, Award (5 September 2008), paras. 164-165.

39 *CC/Devas (Mauritius) Ltd., Devas Employees Mauritius Private Limited and Telecom Devas Mauritius Limited v. India,* PCA Case No. 2013-09, Award on Jurisdiction and Merits (25 July 2016), para. 354.

40 In the face of the Argentine financial crisis, the *Sempra, Enron* and *CMS* tribunals have found NPM clauses inapplicable; whereas the *LG&E* tribunal found an NPM clause applicable and exonerating Argentina.

between NPM clauses and necessity in customary international law; and third, the scope of any particular clause.[41]

First, with respect to the standard of review, the crux of the matter lies in whether NPM clauses are self-judging, thus, excluding any kind of review by an arbitral tribunal. The *Enron* and *Sempra* tribunals noted that the self-judging character of a treaty provision must be clear.[42] Otherwise, a tribunal can review whether the state determination falls within the scope of an NPM clause, albeit conceding a certain margin of appreciation to the party invoking the clause.[43] Exceptionally, IIAs may explicitly conceive NPM clauses as non-justiciable. For instance, Article 6.12(4) of the Indian-Singapore Comprehensive Economic Cooperation Agreement (CECA) of 2005 provides that '[t]his Article shall be interpreted in accordance with the understanding of the Parties on non-justiciability of security exceptions as set out in their exchange of letters.'

Therefore, the self-judging character of NPM clauses is closely linked to the particular wording of the respective treaty provision. However, even in the absence of deference to the state, a tribunal's role focuses on the determination of whether the state's margin of appreciation is compatible with the terms of the particular NPM clause.[44]

Second, with respect to the relation between NPM clauses and necessity under customary international law, the discussion is prompted by a series of cases in the framework of the Argentine financial crisis. The *CMS, Enron* and *Sempra* tribunals seem to have conflated the requirements of treaty NPM clauses and the necessity defence under customary international law.[45] This approach was criticised by the *CMS* Annulment Committee: while NPM clauses exclude the applicability of substantive obligations under the treaty, the necessity defence is triggered once a breach has been found; thus, the latter could only be subsidiary to the former.[46] This latter position was followed by the *CC Devas*[47] and *Deutsche Telekom*[48] tribunals.

Indeed, it is important to note that NPM clauses differ from defences available under customary international law, at least in two respects. On the one hand, defences under customary international

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41 Newcombe and Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (2009), p. 491.

42 *Enron Corporation and Ponderosa Assets v. Argentina*, ICSID Case No. ARB/01/3, Award (22 May 2007), paras. 322-342; *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16, Award (28 September 2007), paras. 364 ff.

43 *Continental Casualty Company v. The Argentine Republic*, ICSID Case No. ARB/03/9, Award (5 September 2008), para. 187.

44 Burke-White and von Staden, *Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties* (2008) 48(2) Va. J. Int'l L., pp. 307-409 (369 ff).

45 See the tribunals deliberations in *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Award (12 May 2005), paras. 373-374; *Enron Corporation and Ponderosa Assets v. Argentina*, ICSID Case No. ARB/01/3, Award (22 May 2007), paras. 333-334; *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16, Award (28 September 2007), paras. 375 ff.

46 *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Decision on Annulment (25 September 2007), paras. 129 ff.

47 *CC/Devas (Mauritius) Ltd., Devas Employees Mauritius Private Limited and Telecom Devas Mauritius Limited v. India*, PCA Case No. 2013-09, Award on Jurisdiction and Merits (25 July 2016), para. 293.

48 *Deutsche Telekom v. India*, PCA Case No. 2014-10, Interim Award (13 December 2017), para. 227.

law are generally available to all states, whereas NPM clauses are treaty provisions applicable only to the contracting parties of the respective treaty. On the other hand, while defences under customary international law protect overriding systematic policy goals, NPM clauses are deemed to respond to particular state objectives.[49]

Third, with respect to the scope of NPM clauses, a tribunal must first analyze whether the particular NPM clause provides for an exhaustive list of measures amounting to essential security interests. For instance, Article 10(4)(b) of the Canada-Peru BIT (2006) specifies measures relating to the traffic in arms, ammunition and implements of war, measures taken in time of war, or with respect to the non-proliferation of nuclear weapons. Otherwise, the concept of 'essential security interests' is usually undefined, and tribunals may consider a variety of situations which might otherwise not be included within the term. In this vein, the *LG&E* tribunal considered that 'essential security interests' can cover economic crises.[50] Some authors even suggest that the term 'essential security interests' may cover urgent measures to tackle the effects of climate change.[51]

Of particular interest in connection with NPM clauses is the application of so-called 'war clauses,' which Argentina raised as a defence argument in various cases to excuse the breach of its treaty obligations. By way of example, Article IV(3) of the Argentina-US BIT (1991) provides that:

> "Nationals or companies of either Party whose investments suffer losses in the territory of the other Party owing to war or other armed conflict, revolution, state of national emergency, insurrection, civil disturbance or other similar events shall be accorded treatment by such other Party no less favorable than that accorded to its own nationals or companies or to nationals or companies of any third country, whichever is the more favorable treatment, as regards any measures it adopts in relation to such losses."

However, these clauses do not derogate from the substantive protection guaranteed by IIAs, nor do they exclude responsibility of the respondent host state. As held by the *Enron, Sempra* and *BG Group* tribunals, the purpose of war clauses is to provide a minimum equal treatment to investors in cases of armed conflict, revolution etc., ensuring that any measure adopted by the host state to compensate losses arising out those situations is non-discriminatory.[52] Thus, these clauses do not intend to fend off investor claims and are distinguishable from NPM clauses, or any other exception clauses for that matter.[53]

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49 Burke-White and von Staden, *Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties* (2008) 48(2) Va. J. Int'l L., pp. 307-409 (321-322). They authors also argue that customary defences excuse the breach after the fact, thus excluding responsibility, NPM clauses exclude wrongfulness; nevertheless, this distinction might not always be true, as will be elaborated below [C].

50 *LG&E Energy Corp./LG&E Capital Corp./LG&E International Inc. v. The Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability (3 October 2006), paras. 226 ff.

51 See, for example, Van Vaerenbergh and Hazarika, *Climate Change as a Security Risk: Too Hot to Handle?* (2020) 54(3) JWT, pp. 417-438 (431).

52 *Enron Corporation and Ponderosa Assets v. Argentina*, ICSID Case No. ARB/01/3, Award (22 May 2007), paras. 320-321; *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16, Award (28 September 2007), paras. 362-363; *BG Group plc v. Argentina*, UNCITRAL Case, Final Award (24 December 2007), paras. 381-387.

53 Newcombe and Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (2009), p. 500.

III. Precluded Investor Claims and Precluded Host State Defences

Under this category of defence arguments, the investor's claim is in principle within the scope of applicability of the treaty and not subject to any specific limitations. However, the claimant investor is prevented from relying on the particular treaty and dispute settlement mechanism due to inappropriate behavior on its part, which does not necessarily entail bad faith.[54] As such, the most common defence arguments in this regard are estoppel, acquiescence, extinctive prescription, abuse of rights, and the 'clean hands' doctrine.

The principle of **estoppel** precludes a party from acting inconsistently with a previous statement or representation which the other party has relied upon.[55] In the context of investment arbitration, the *Pope & Talbot* tribunal conceived the elements of estoppel as '(i) a statement of fact which is clear and unambiguous; (ii) this statement must be voluntary, unconditional, and authorised; and (iii) there must be reliance in good faith upon the statement either to the detriment of the party so relying on the statement or to the advantage of the party making the statement.'[56] Although states have argued estoppel in various cases,[57] this has rarely been successful.

Public international law recognizes **acquiescence**, whereby an injured state/party is prevented from invoking a treaty breach if it has 'validly acquiesced in the lapse of time.'[58] Accordingly, the International Court of Justice (ICJ) has equated acquiescence to tacit recognition 'manifested by unilateral conduct which the other party may interpret as consent.'[59] Although the principle of acquiescence arises from inter-state relations, nothing impedes its application in investor-state arbitration.[60] For instance, the *MCI Power* tribunal upheld that the investor had acquiesced in the cancellation of a permit since it never sought administrative review.[61]

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54 Viñuales, *Defence Arguments in Investment Arbitration*, in Viñuales and Waibel (eds), *ICSID Reports: Volume 18* (2020), pp. 9-108, para. 40.

55 The principle has been recognized many times, including by the International Court of Justice. See, for example, *Land, Island and Maritime Frontier Dispute (El Salvador/Honduras: Nicaragua intervening)*, Judgment, 13 September 1990, ICJ Reports (1990), 118 (para. 63).

56 *Pope & Talbot Inc. v. The Government of Canada*, UNCITRAL Case, Interim Award (26 June 2000), para. 111. Although these elements are widely recognized, tribunals such as *Bankwswitch v Ghana* divide the last element into two, see *Bankswitch Ghana Ltd. v. The Republic of Ghana acting as the Government of Ghana*, PCA Case No. 2011-10, Award (11 April 2014), para. 11.81: 'As applicable to this case, the elements of estoppel include (i) an unambiguous statement or representation by the Respondent (either through words or conduct); (ii) which is voluntary, unconditional and authorised; (iii) which is relied on by the Claimant in good faith; and (iv) with such reliance operating either to the detriment of the Claimant or the advantage of the Respondent.'

57 For instance, *Pope & Talbot Inc. v. The Government of Canada*, UNCITRAL Case, Interim Award (26 June 2000), para. 112; *Pan American Energy LLC, and BP Argentina Exploration Company v. Argentina*, ICSID Case No. ARB/03/13/, Decision on Preliminary Objections (27 July 2006), paras. 159ff; *UAB E energija (Lithuania) v. Republic of Latvia*, ICSID Case No. ARB/12/33, Award (22 December 2017), paras. 533.

58 ILC Articles on the Responsibility of States for Internationally Wrongful Acts (ARSIWA), Article 45(b).

59 *Delimitation of the Maritime Boundary in the Gulf of Maine Area (Canada/United States)*, Judgment, 12 October 1984, ICJ Reports (1984), 246 (para. 130).

60 Newcombe and Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (2009), p. 524.

61 *M.C.I. Power Group L.C. and New Turbine, Inc. v. Republic of Ecuador*, ICSID Case No. ARB/03/6, Award (31 July 2007), para. 302.

According to the principle of **extinctive prescription**, a claimant may be barred from bringing a claim by the passing of time.[62] In the context of investment arbitration, even in the absence of time limitations explicitly spelled out in the underlying treaty, the *Wena Hotels, Salini Impregilo*, and *Caratube* tribunals have considered extinctive prescription as a general principle of law.[63] However, the defence argument of extinctive prescription would require the tribunal to analyze whether the lapse of time represents a disadvantage to the respondent's right to defence.[64]

In the *UAB E energija* case, the respondent contended that the investor was barred from bringing the claim given the lapse of 42 months after the initial negotiations with the state, and it relied for this purpose on the principles of estoppel, acquiescence and extinctive prescription.[65] Nevertheless, the tribunal found that the respondent failed to prove the elements of any of those defence arguments and upheld its jurisdiction.[66]

The doctrine of **abuse of right** (*abus de droit*) is a manifestation of the principle of good faith.[67] Accordingly, the *Orascom* tribunal determined that abuse of rights 'prohibits the exercise of a right for purposes other than those for which the right was established.'[68] As such, it does not require proof of bad faith.[69] The most common manifestation of abuse of rights in investment arbitration constitutes the so-called 'treaty shopping.'[70] In this regard, the *Philip Morris (Asia)* tribunal defined treaty shopping as the situation where an 'investor who is not protected by an investment treaty restructures its investment in such a fashion as to fall within the scope of protection of a treaty in

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62 Cheng, *General Principles of Law: As Applied by International Courts and Tribunals* (1953), p. 373; *Case Concerning Certain Phosphate Lands in Nauru (Nauru/Australia)*, Preliminary Objections, 26 June 1992 ICJ Reports (1992), 253 (para. 31).

63 *Wena Hotels Ltd v Arab Republic of Egypt*, ICSID Case No ARB/98/4, Award (8 December 200), para. 106; *Salini Impregilo SpA v Argentine Republic*, ICSID Case No ARB/15/39, Decision on Jurisdiction Admissibility (23 February 2018), para. 89; *Caratube International Oil Company LLP and Devincci Salah Hourani v Republic of Kazakhstan*, ICSID Case No ARB/13/13, Award (27 September 2017), para. 424.

64 For a full analysis on extinctive prescription see, Alvarado-Garzón, *Compensation with a Chess Clock? The Interaction of Statutes of Limitation with the Calculation of Damages in Investment Arbitration*, in Sachs, Johnson and Coleman (eds), *Yearbook on International Investment Law & Policy 2019* (2021), pp. 405-424 (paras. 21.05 ff).

65 *UAB E energija (Lithuania) v. Republic of Latvia*, ICSID Case No. ARB/12/33, Award (22 December 2017), paras. 472-473.

66 Id., paras. 531-540.

67 Ziegler and Baumgartner, *Good Faith as a General Principle of (International) Law*, in Mitchell, Sornarajah and Voon (eds), *Good Faith and International Economic Law* (2015), pp. 9-36 (12); Dumberry, *A Guide to General Principles of Law in International Investment Arbitration* (2020), para. 4.238.

68 *Orascom TMT Investments S.à r.l. v. People's Democratic Republic of Algeria*, ICSID Case No. ARB/12/35, Award (31 May 2017), para. 540.

69 *Philip Morris Asia Limited v. The Commonwealth of Australia*, UNCITRAL, PCA Case No. 2012-12, Award on Jurisdiction and Admissibility (17 December 2015), para 539.

70 For a discussion of arbitral awards discussing some forms of treaty shopping that constitute abuse of process and the new trends in treaty drafting to tackle this issue, see Böhme, *Recent Efforts to Curb Investment Treaty Shopping: How Effective Are They?* (2021) 38(4) J. Int'l Arb., pp. 511-532.

view of a specific foreseeable dispute.'[71] These kind of abuse tactics may deprive the claimant investor from relying on an otherwise applicable investment treaty and dispute settlement mechanism.

The **'clean hands' doctrine** prescribes that if an investor has acted illegally or improperly its claims may be barred from jurisdiction.[72] However, the wrongdoing or fraudulent act must be related to the subject-matter of the claim.[73] Tribunals have held that an investment is not protected if it was made contrary to the law even in the absence of legality requirements in the treaty.[74] For instance, the *Plama* tribunal deemed that the investor had concealed facts concerning its financial and managerial capacities. Thus, the investor could not rely on the substantive protection under the applicable treaty.[75] Additionally, it must be noted that not only an investor's illegal or improper behavior but also a third party's illegal actions may render a claim inadmissible, if the investor bears responsibility for the third party acts or omissions, for example due to the investor's lack of due diligence.[76] The *Churchill* tribunal found that the presence of fraud and forged documents to obtain mining rights tainted the claimant's investment and rendered its claims inadmissible, since those facts were deliberately and unreasonably ignored by the claimant.[77]

IV. Absence of Breach

Defence arguments aimed at disproving the existence of a breach presuppose that the treaty is applicable in the particular case and the claimant investor is entitled to rely on the dispute settlement mechanism thereunder. Although the assessment of whether the respondent host state has breached an investment treaty hinges on the evidence submitted by the parties, there are some common arguments that seek to fend off the finding of a breach based on the legitimate exercise of the state's right to regulate and the 'margin of appreciation' doctrine.

The **right to regulate** is based on the premise that the legitimate exercise of sovereignty cannot be wrongful, nor trigger a claim for compensation.[78] Thus, international law recognizes the

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71 *Philip Morris Asia Limited v. The Commonwealth of Australia*, UNCITRAL, PCA Case No. 2012-12, Award on Jurisdiction and Admissibility (17 December 2015), para 539.

72 Llamzon, *Yukos Universal Limited (Isle of Man) v The Russian Federation: The State of the "Unclean Hands" Doctrine in International Investment law: Yukos as both Omega and Alpha* (2015) 30(2) ICSID Rev.-FILJ, pp. 315-325 (316).

73 Cheng, *General Principles of Law: As Applied by International Courts and Tribunals* (1953), p. 155; Dumberry, *A Guide to General Principles of Law in International Investment Arbitration* (2020), para. 4.103.

74 *Phoenix Action, Ltd. v. The Czech Republic*, ICSID Case No. ARB/06/5, Award (15 April 2009), para. 101; *SAUR International SA v. Republic of Argentina*, ICSID Case No. ARB/04/4, Decision on Jurisdiction and Liability (6 June 2012), para. 308; *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, UNCITRAL, PCA Case No. 2005-04/AA227, Award (18 July 2014), para. 1352.

75 *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award (27 August 2008), paras. 143 ff.

76 *Alasdair Ross Anderson et al v. Republic of Costa Rica*, ICSID Case No. ARB(AF)/07/3, Award (19 May 2010), paras. 55 ff.

77 *Churchill Mining PLC and Planet Mining Pty Ltd v. Republic of Indonesia*, ICSID Case No. ARB/12/14 and 12/40, Award (6 December 2016), para. 528.

78 Martinez, *Invoking State Defenses in Investment Treaty Arbitration*, in Waibel et al. (eds), *The Backlash Against Investment Arbitration* (2010), pp. 315-337 (332). For a definition of the right to regulate see Titi, *The*

sovereign right of domestic authorities to regulate, to adapt their legal order, as they deem necessary,[79] and that states do not automatically relinquish this right by signing IIAs.[80] Particularly, in the case of claims of indirect expropriation, the *Methanex* tribunal found that 'non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and which affects, inter alia, a foreign investor or investment, is not deemed expropriatory.'[81] This is recognised as the *'police powers' doctrine*,[82] which has been addressed in more detail elsewhere.[83]

However, defence arguments based on the sovereign right to regulate are not circumscribed exclusively to claims of (indirect) expropriation. As held by the *Saluka* tribunal, in the assessment of FET violations, 'the host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well.'[84] In the same vein, the *Parkerings* tribunal held:

> It is each State's undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a stabilisation clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment. As a matter of fact, any businessman or investor knows that laws will evolve over time. What is prohibited however is for a State to act unfairly, unreasonably or inequitably in the exercise of its legislative power.[85]

As such, the right to regulate as a defence argument does not want to excuse a breach of the investment treaty, but rather it strives to fend off the allegation that a breach has even occurred.[86] However, irrespective of recognizing the regulatory freedom that states enjoy in their own territory, it seems that most tribunals have paid only lip service to the right to regulate since ultimately, they have ruled against the respondent host states in a majority of cases.[87]

Right to Regulate in International Investment Law (2014), p. 33: ('the legal right exceptionally permitting the host state to regulate in derogation of international commitments it has undertaken by means of an investment agreement without incurring a duty to compensate').

79 *S.D. Myers, Inc. v. Government of Canada, UNCITRAL Case, Partial Award (13 November 2000), para. 263.*

80 *Total S.A. v. The Argentine Republic*, ICSID Case No. ARB/04/01, Decision on Liability (27 December 2010), para. 115.

81 *Methanex Corporation v. United States of America*, UNCITRAL Rules Final Award on Jurisdiction and Merits, (3 August 2005), pt IV ch D para. 7.

82 See also *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award (29 May 2003), para. 119. Similarly, *Chemtura Corporation v. Government of Canada*, UNCITRAL Case, Award (2 August 2010), para. 266.

83 See, in particular, Chapter 2.2: Guarantees Against Expropriation by Csongor Istvàn Nagy.

84 *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL Case, Partial Award (17 March 2006), para. 305.

85 *Parkerings-Compagniet AS v. Republic of Lithuania*, ICSID Case No. ARB/05/8, Award (11 September 2007), para. 332.

86 Martinez, *Invoking State Defenses in Investment Treaty Arbitration*, in Waibel et al. (eds), *The Backlash against Investment Arbitration* (2010), pp. 315-337 (337).

87 Titi, *The Right to Regulate in International Investment Law* (2014), p. 289.

This may explain a recent trend in treaty drafting whereby contracting states prefer to explicitly include treaty provisions excluding their responsibility for the legitimate exercise of their right to regulate. For instance, Annex 10-C(4)(b) of the Free Trade Agreement between Central America, the Dominican Republic and the United States (CAFTA-DR) and Annex 10-B(4)(b) of the Oman-United States Free Trade Agreement (FTA) provide that certain regulatory actions do not constitute indirect expropriation. Similarly, Article 8.9 of the Comprehensive Economic and Trade Agreement between Canada and the European Union (CETA) reaffirms the parties' right to regulate, and clarifies the consequences thereof. Given the express treaty wording preserving a state's right to regulate in the public interest, tribunals are going to have to grant a higher deference to future state actions.[88]

The **margin of appreciation** doctrine responds to the concerns about increased power of review granted to international adjudicators over national decision-makers, particularly with regards to their legitimacy and capacity.[89] The doctrine posits that the state is in a better position to decide how best to promote public welfare[90] and, therefore, must be afforded a degree of deference when assessing regulatory action undertaken in the public interest.[91] The margin of appreciation doctrine has been extensively but rather exclusively developed by the European Court of Human Rights (ECtHR), which led the *von Pezold* tribunal to reject the applicability of the doctrine in investment arbitration.[92]

By contrast, the majority of the *Philip Morris* tribunal dismissed the claimant's claims by arguing that the doctrine applies to investment arbitration as well, and it further stated that the 'responsibility for public health measures rests with the government and investment tribunals should pay great deference to governmental judgments of national needs in matters such as the protection of public

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88 This seems to be the position of, for instance, the *Al Tamimi* tribunal, see *Adel A Hamadi Al Tamimi v. Sultanate of Oman*, ICSID Case No. ARB/11/33, Award (3 November 2015), paras. 368-369: ('… After 17 February 2009, the Claimant had no primary investment capable of being expropriated. Any claim for indirect expropriation based on the Respondent's actions after 17 February 2009 would also have to confront the express stipulation in Annex 10-B.4(b) of the US-Oman FTA that non-discriminatory regulatory actions by a State designed and applied to protect legitimate public welfare objectives, including protection of the environment – and, the Tribunal infers, the enforcement of Omani private property laws – do not constitute indirect expropriations. It follows that the Claimant has not established a claim against Oman for expropriation of his primary investment'). For further discussion see also *Chapter 6.1: The Crisis of Investor-State Dispute Settlement*, as well as *Chapter 6.2: ISDS Reform Efforts by UNCITRAL Working Group III* by Fahira Brodlija.

89 Shany, *Toward a General Margin of Appreciation Doctrine in International Law?* (2006) 16(5) EJIL, pp. 907-940 (908-909).

90 Benvenisti, *Margin of Appreciation, Consensus, and Universal Standards* (1998) 31 NYU International Law and Politics, pp. 843-854 (843); Shany, *Toward a General Margin of Appreciation Doctrine in International Law?* (2006) 16(5) EJIL, pp. 907-940 (907).

91 See, for example, *Handyside v United Kingdom*, ECtHR Application No. 5493/72, Judgment, 7 December 1976, A 24 (para 48).

92 *Bernhard von Pezold and Others v. Republic of Zimbabwe*, ICSID Case No. ARB/10/15, Award (28 July 2015), para. 465: ('the Tribunal is of the opinion that due caution should be exercised in importing concepts from other legal regimes (in this case European human rights law) without a solid basis for doing so. Balancing competing (and non-absolute) human rights and the need to grant States a margin of appreciation when making those balancing decisions is well established in human rights law, but the Tribunal is not aware that the concept has found much support in international investment law. The Respondent has only referred the Tribunal to European human rights cases in its arguments').

health.'[93] However, the dissenting arbitrator Gary Born criticised the tribunal's decision, holding that '[t]he "margin of appreciation" is a specific legal rule, developed and applied in a particular context, that cannot properly be transplanted to the BIT (or to questions of fair and equitable treatment more generally).'[94]

C. DEFENCES AT THE LEVEL OF SECONDARY NORMS

Defences at the level of secondary norms presuppose the existence of a breach of a primary obligation in the respective IIA. However, under certain circumstances, which need not be prescribed by the underlying treaty, the breach might be excused, thereby releasing the respondent from liability. The complexity of this category of defence arguments lies in the multitude of sources. They may arise from public international law, domestic law, or may be recognised at both levels.[95]

In the realm of public international law, the most common defences consist of consent, self-defence, countermeasures, force majeure, distress and necessity. These defences are denominated 'circumstances precluding wrongfulness' and reflected in the ILC Articles on the Responsibility of States for Internationally Wrongful Acts (ARSIWA).[96] The label 'precluding wrongfulness' might be questionable, however.[97] There is a difference between conduct that is legal, and conduct that is illegal but excused conduct, which ARSIWA seems to omit.[98] Whilst circumstances precluding wrongfulness transform a state conduct, which would otherwise be prohibited, into a lawful conduct (there is no breach),[99] circumstances precluding responsibility excuse an unlawful conduct (there is a breach, but it is justified). Accordingly, there should be some flexibility in classifying the circumstances described under ARSIWA since, in some cases, it might be more appropriate to talk about an absence of breach, whereas in others about a *justified* breach.[100] The distinction is apposite from a policy perspective since the normative value of a rule may be weakened by treating an act as 'legal' rather than 'illegal but justified.'[101]

Before delving into details, two preliminary observations are necessary. First, although circumstances precluding wrongfulness *stricto sensu* will be better addressed as a *Defence at the Level of Primary Norms*, for the purpose of convenience they will be dealt with in this section. Second,

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93 *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Award (8 July 2016), para. 399.

94 Id., Concurring and Dissenting Opinion Gary Born (8 July 2016), para. 87.

95 Viñuales, *Defence Arguments in Investment Arbitration*, in Viñuales and Waibel (eds), *ICSID Reports: Volume 18* (2020), pp. 9-108, para. 112.

96 ARSIWA, Chapter V, Articles 20-27, available at https://legal.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf.

97 Viñuales, *Seven Ways of Escaping a Rule: Of Exceptions and their Avatars in International Law*, in Bartels and Paddeu (eds), *Exceptions in International Law* (2020), pp. 65-87 (74).

98 Lowe, *Precluding Wrongfulness or Responsibility: A Plea for Excuses* (1999) 10(2) EJIL, pp. 405-411 (406).

99 Viñuales, *Seven Ways of Escaping a Rule: Of Exceptions and their Avatars in International Law*, in Bartels and Paddeu (eds), *Exceptions in International Law* (2020), pp. 65-87 (76).

100 Lowe, *Precluding Wrongfulness or Responsibility: A Plea for Excuses* (1999) 10(2) EJIL, pp. 405-411 (411).

101 Id., at 410. See also Viñuales, *Seven Ways of Escaping a Rule: Of Exceptions and their Avatars in International Law*, in Bartels and Paddeu (eds), *Exceptions in International Law* (2020), pp. 65-87 (76).

only those defences under public international law that have been relevant in investment arbitration will be addressed.

With respect to **consent or waiver**, according to Article 20 ARSIWA '[v]alid consent by a State to the commission of a given act by another State precludes the wrongfulness of that act in relation to the former State to the extent that the act remains within the limits of that consent.' There are two types of consent, (i) consent given before or at the same time the act occurs, or (ii) consent given after the act has occurred (waiver or acquiescence).[102] In the context of treaty-based investment arbitration, the thorniest issue with regards to consent/waiver as a defence argument arises out of the two-fold relations of the host state: towards the home state and treaty partner, and towards the investor.

Considering that investors bring a cause of action based on their own rights,[103] a home state's consent/waiver to a treaty breach affecting the investor might be ineffective as a defence argument.[104] The question remains whether the investor itself could validly consent (or waive) a treaty breach. In this regard, the *SGS* tribunal held that it 'is, to say the least, doubtful that a private party can by contract waive rights or dispense with the performance of obligations imposed on the States parties to those treaties under international law.'[105] In this vein, some authors argue that given the more general public interest in maintaining minimum standards of protection against denial of justice or discriminatory treatment, investors might not be able to consent/waive treaty breaches.[106] That does not mean, however, that those investors cannot waive their right to bring claims based on treaty breaches they consented to.

The defence argument on **necessity** is devised under Article 25 ARSIWA[107] and conceives that, in exceptional cases, a state may fail to abide by an international obligation in order to safeguard an essential interest, which is threatened by a grave and imminent peril.[108] In *Gabčíkovo-*

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102 ILC, *Responsibility of States for Internationally Wrongful Acts: General Commentary*, in Report of the International Law Commission on the Work of Its Fifty-Third Session, UN GAOR, 56th Sess., Supp. No. 10, UN Doc. No. A/56/10 (2001), Article 20, mn. 3.

103 Douglas, *The Hybrid Foundations of Investment Treaty Arbitration* (2003) 74(1) BYIL, pp. 151-289 (182); *Republic of Ecuador v. Occidental Exploration and Production Co.* [2006] Q.B. 432, Court of Appeal (9 September 2005), p. 452.

104 Newcombe and Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (2009), p. 512.

105 *SGS Société Générale de Surveillance S.A. v. Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction (29 January 2004), para. 154.

106 Newcombe and Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (2009), p. 513.

107 ARSIWA, Article 25 Necessity states '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.'

108 ILC, *Responsibility of States for Internationally Wrongful Acts: General Commentary*, in Report of the International Law Commission on the Work of Its Fifty-Third Session, UN GAOR, 56th Sess., Supp. No. 10, UN Doc. No. A/56/10 (2001), Article 25, mn. 1.

Nagymaros the ICJ recognised necessity as a defence deeply rooted in customary international law, albeit accepted on an exceptional basis only.[109] Certainly, necessity is distinct from other defence arguments in the sense that it does not require a prior conduct of the injured party and involves an element of free will.[110]

In the context of investment arbitration, necessity has been a bone of contention. Against the background of the 2001-2002 financial crisis in Argentina, when that state was flooded with investment claims, given the regulatory measures taken to cope with the situation, tribunals have disparately decided on the plea of necessity. For instance, the *LG&E* tribunal upheld the respondent's plea of necessity precluding state responsibility for a certain period.[111] However, the *Enron* and *BG Group* tribunals have rejected the plea of necessity, given the failure to fulfil the requirements under customary international law.[112]

Another defence argument under public international law is the argument that **countermeasures** had to be taken against a prior act of the other party. Pursuant to Article 22 ARSIWA '[t]he wrongfulness of an act of a State not in conformity with an international obligation towards another State is precluded if and to the extent that the act constitutes a countermeasure taken against the latter State.' Countermeasures, however, are only permitted under certain conditions, with certain objectives and limits, and if they respect obligations not affected by the trigger measure(s), among other specifications.[113]

In the context of investment arbitration, respondent host states have raised the defence argument of countermeasures with different results. The *ADM* tribunal concluded that countermeasures are in principle available as a defence argument in treaty-based investment arbitration, though in the particular case, the requirements were not fulfilled.[114] Conversely, the *Corn Products* tribunal rejected the applicability of countermeasures as a defence argument, considering that they refer exclusively to inter-state relations.[115] Some authors advocate for the reconsideration of countermeasures as defence arguments, or at least a more appropriate explanation for their rejection.[116]

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109 *Gabčíkovo-Nagymaros Project (Hungary/Slovakia)*, Judgment, 25 September 1997, ICJ Reports (1997), 7 (para. 51).

110 ILC, *Responsibility of States for Internationally Wrongful Acts: General Commentary*, in Report of the International Law Commission on the Work of Its Fifty-Third Session, UN GAOR, 56th Sess., Supp. No. 10, UN Doc. No. A/56/10 (2001), Article 25, mn. 2; see also Martinez, *Invoking State Defenses in Investment Treaty Arbitration*, in Waibel et al. (eds), *The Backlash Against Investment Arbitration* (2010), pp. 315-337 (319).

111 *LG&E Energy Corp./LG&E Capital Corp./LG&E International Inc. v. The Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability (3 October 2006), paras. 257 ff.

112 *Enron Corporation and Ponderosa Assets v. Argentina*, ICSID Case No. ARB/01/3, Award (22 May 2007), paras. 307-313; *BG Group Plc. v. The Republic of Argentina*, UNCITRAL Case, Award (24 December 2007), paras. 408-412.

113 ARSIWA, Articles 49 ff.

114 *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/04/5, Award (21 November 2007), paras. 120 ff.

115 *Corn Products International Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/04/1, Decision on Responsibility (15 January 2008), paras. 145 ff.

116 Viñuales, *Defence Arguments in Investment Arbitration*, in Viñuales and Waibel (eds), *ICSID Reports: Volume 18* (2020), pp. 9-108, para. 127: 'The distinction between obligations owed to other States and

In a variety of cases, respondent states have raised defence arguments based on force majeure and hardship. The concept of **force majeure** is recognized both by international and national law.[117] In international law, Article 23 ARSIWA provides that '[t]he wrongfulness of an act of a State not in conformity with an international obligation of that State is precluded if the act is due to force majeure, that is the occurrence of an irresistible force or of an unforeseen event, beyond the control of the State, making it materially impossible in the circumstances to perform the obligation.' This defence however does not apply if the respondent host state has provoked the situation or assumed its risk.[118] The main difference between force majeure and other defences such as necessity lies in volition. While in necessity, there is an element of free choice, in force majeure the state cannot fulfil its obligation given an irresistible force or an unforeseen event.[119]

Force majeure has usually been raised as a defence argument under domestic law, to fend off a breach of contractual obligations. In the *Autopista Concesionada* case, the respondent advanced the argument of force majeure to excuse the failure to increase toll rates as provided by the concession agreement based on civil unrest in the country. The tribunal nevertheless rejected the allegation given that the civil unrest was neither unforeseeable nor irresistible.[120] In the *CMS* case, the respondent raised the force majeure argument, but the tribunal swiftly dismissed the argument, stating that the financial crises were foreseeable.[121] By contrast, the *General Dynamics* tribunal recognized that the respondent could rely on force majeure given the 2011 Libyan civil war and foreign military intervention, excusing the default of the contract during that period.[122]

Similarly, based on domestic law, respondent host states have advanced defence arguments based on **hardship** or **théorie de l'imprévision**. Hardship recognizes the unforeseen occurrence of events fundamentally affecting the equilibrium of a contract as reasons for the disadvantaged party

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obligations owed to investors may not be a sufficient basis for excluding the operation of the doctrine of countermeasures. It would be difficult to argue that the *exceptio non adimplenti contractus*, the synallagmatic character of which is comparable to that of the doctrine of countermeasures, could not suspend the rights of foreign investors (…) They are commercial advantages granted by one State to the investor of another State because the overall deal with the home State makes such concessions advantageous as a reciprocal matter (…) it is hoped that investment tribunals will also perceive it or, at least, will provide a more satisfactory explanation of why such 'rights' should be immune to reciprocity considerations') (footnotes omitted).

117 *The Russian Indemnity Case (Russia/Turkey)*, PCA Case, Award 11 November 1912, RIAA 421 (1912); Martinez, *Invoking State Defenses in Investment Treaty Arbitration*, in Waibel et al. (eds), *The Backlash Against Investment Arbitration* (2010), pp. 315-337 (317).

118 ARSIWA, Article 23(2).

119 ILC, *Responsibility of States for Internationally Wrongful Acts: General Commentary*, in Report of the International Law Commission on the Work of Its Fifty-Third Session, UN GAOR, 56th Sess., Supp. No. 10, UN Doc. No. A/56/10 (2001), Article 23, mn. 1.

120 *Autopista Concesionada de Venezuela, C.A. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/00/5, Award (23 September 2003), paras. 107 ff.

121 *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Award (12 May 2005), para. 227.

122 *General Dynamics United Kingdom Ltd. v. The State of Libya*, ICC Case No. 19222/EMT, Award (5 January 2016), paras. 245 ff.

to request the renegotiation of the contract.[123] In investment arbitration, respondents have advanced hardship as a defence argument for the breach of investment contracts rather unsuccessfully.[124]

D. TREATY EXCEPTION CLAUSES: ENTERING THE GREY ZONE OF DEFENCES

Exception clauses in IIAs cover a wide range of provisions intended to preserve the state's regulatory freedom with regard to safeguarding specific interests, in particular related to public health, the protection of the environment, and labor standards.[125] Treaty practice shows that, in newer IIAs, states have incorporated general exception clauses mirroring,[126] or modelled upon,[127] the general exceptions in Article XX of the General Agreement on Tariffs and Trade (GATT). The reason behind the inclusion of exception clauses in IIAs may lie in the state's intention to 'guide and constrain' the decision-making of arbitral tribunals, particularly in cases where non-discriminatory measures aimed at the protection of a public interest are undertaken.[128]

The actual impact on the state's regulatory powers of including exception clauses in IIAs is strongly linked to the wording of the provisions and their context.[129] Nevertheless, some authors point to certain practical effects of any such inclusion. For instance, exceptions may constitute a compromise to accept treaty obligations that would not be otherwise agreed upon. Exceptions may also prevent states from presenting strained or counterintuitive interpretations of treaty obligations in order to preserve their regulatory freedom in particular situations.[130] Almost invariably, contracting states consider that the inclusion of exceptions in IIAs – however phrased – increases their regulatory autonomy.[131] Indeed, one may argue that when faced with explicit treaty exceptions,

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123 See, §313 Bürgerliches Gesetzbuch (Germany); Article 1195 Code Civil (France); Article 1467 Codice Civile (Italy); Article 1091 Código Civil y Comercial (Argentina); similarly, UNIDROIT Principles, Articles 6.2.2 and 6.2.3.

124 See, for instance, *Enka İnşaat ve Sanayi A.Ş. v. The Gabonese Republic*, ICC Arbitration No. 22841/DDA, Final Award (14 September 2018), paras. 226 ff; *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16, Award (28 September 2007), paras. 243 ff.

125 Choudhary, *Much Ado About Nothing: The Case Against Replicating Article XX(g), GATT 1994 in International Investment Agreements* (2020) 23(1) Zeitschrift für Europarechtliche Studien ZEuS, pp. 195-223 (205-206).

126 Legum and Petculescu, *GATT Article XX and International Investment Law*, in Echandi and Sauvé (eds), *Prospects in International Investment Law and Policy* (2013), pp. 340-362 (344); Taniguchi and Ishikawa, *Balancing Investment Protection and Other Public Policy Goals: Lessons from WTO Jurisprudence*, in Chaisse and Lin (eds), *International Economic Law and Governance: Essays in Honour of Mitsuo Matsushita* (2016), pp. 68-93 (73).

127 Henckels, *Scope Limitation or Affirmative Defence? The Purpose and Role of Investment Treaty Exception Clauses*, in Bartels and Paddeu (eds), *Exceptions in International Law* (2020), pp. 363-374 (364).

128 Id., at p. 363.

129 Mitchell, Munro and Voon, *Importing WTO General Exceptions into International Agreements: Proportionality, Myths and Risks*, in Sachs, Johnson and Coleman (eds), *Yearbook on International Investment Law & Policy 2017* (2019), pp. 305-355 (para. 19.60).

130 Vandevelde, *Rebalancing Through Exceptions* (2013) 17(2) Lewis & Clark L. Rev., pp. 449-460 (455).

131 Mitchell, Munro and Voon, *Importing WTO General Exceptions into International Agreements: Proportionality, Myths and Risks*, in Sachs, Johnson and Coleman (eds), *Yearbook on International Investment Law & Policy 2017* (2019), pp. 305-355 (para. 19.60); Henckels, *Scope Limitation or Affirmative*

arbitrators give a higher degree of deference to state determinations in relation to the circumstances covered by those exceptions.[132]

Be that as it may, treaty exception clauses in IIAs represent a grey zone of defence arguments given their intricate functioning and debates about their utility. In particular, there is a need for an appropriate classification of exception clauses either as excluding wrongfulness or as precluding responsibility and the consequences thereof [I]. Moreover, some authors posit that the inclusion of exception clauses has a counterproductive effect on the state's regulatory powers [II].

I. Wrongfulness or Responsibility? Reasons Behind an Appropriate Classification

In principle, exceptions are methodologically different to similar treaty provisions preserving the state's regulatory freedom such as carve-outs or non-precluded measures. Exceptions presuppose a breach that can be excused under specific circumstances provided for in the treaty, whereas carve-outs or non-precluded measures presuppose that no breach has occurred given a provision limiting the treaty's applicability.[133]

However, one could conceive exceptions as clauses confirming that certain measures are not captured by the treaty obligations, thus, precluding the finding of a breach.[134] Indeed, the term 'exception' has been used interchangeably to denote carve-outs[135] or even non-precluded measures.[136] Importantly, the determination of whether an exception is deemed to exclude wrongfulness or responsibility might have different political connotations because states may prefer to maintain certain conduct outside of the scope of the treaty obligations rather than to treat it as a justified breach.[137]

Ultimately, whether the application of a treaty provision excuses a breach or prevents its finding hinges primarily on its wording. As such, the particular exception provision may be worded in a manner that presupposes a breach or that prevents the finding of a breach. Should such clear

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Defence? The Purpose and Role of Investment Treaty Exception Clauses, in Bartels and Paddeu (eds), *Exceptions in International Law* (2020), pp. 363-374 (363).

132 Burke-White and von Staden, *Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties* (2008) 48(2) Va. J. Int'l L., pp. 307-409 (372); Choudhary, *Much Ado About Nothing: The Case Against Replicating Article XX(g), GATT 1994 in International Investment Agreements* (2020) 23(1) Zeitschrift für Europarechtliche Studien ZEuS, pp. 195-223 (196).

133 Viñuales, *Defence Arguments in Investment Arbitration*, in Viñuales and Waibel (eds), *ICSID Reports: Volume 18* (2020), pp. 9-108, para. 104.

134 Henckels, *Scope Limitation or Affirmative Defence? The Purpose and Role of Investment Treaty Exception Clauses*, in Bartels and Paddeu (eds), *Exceptions in International Law* (2020), pp. 363-374 (364-365).

135 For instance, Newcombe and Paradell compared the concepts of 'exceptions' and 'reservations,' coming to the conclusion that both entail the same practical effect, namely that no treaty obligation exists with respect to a measure within the scope of the exception or reservation, see Newcombe and Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (2009), p. 482.

136 See, for instance, Vandevelde, *Rebalancing through Exceptions* (2013) 17(2) Lewis & Clark L. Rev., pp. 449-460 (449ff); Legum and Petculescu, *GATT Article XX and International Investment Law*, in Echandi and Sauvé (eds), *Prospects in International Investment Law and Policy* (2013), pp. 340-362 (348).

137 Henckels, *Scope Limitation or Affirmative Defence? The Purpose and Role of Investment Treaty Exception Clauses*, in Bartels and Paddeu (eds), *Exceptions in International Law* (2020), pp. 363-374 (371).

language not be provided, this raises the question as to the proper characterization of the exception(s). Considering that the increasingly frequent inclusion of treaty exceptions in IIAs signals the contracting parties' intention to rebalance their substantive obligations,[138] exceptions in IIAs should be characterized as 'limitations on the scope of substantive obligations.'[139] In other words, they exclude the application of the particular treaty obligations in particular circumstances.

Given that the default rule in international adjudication is that the party making an affirmative claim bears the burden of proof,[140] distinguishing between exception clauses that exclude wrongfulness from those that preclude responsibility has an impact on the allocation of the burden of proof. If the exception clause is deemed to limit the scope of substantive obligations, the burden of proof falls on the claimant to demonstrate that the exception does not apply in the particular case. However, if the exception clause is deemed as excluding responsibility, the respondent would bear the burden of proof.[141]

II. The Unintended Consequences of Exception Clauses

Some authors have heavily criticized the incorporation of exception clauses into IIAs, particularly, with regard to their utility, and perhaps unintended restriction of regulatory powers. Like Article XX GATT,[142] exception clauses in IIAs cover measures aimed at the protection of a listed public interest, whose application is neither discriminatory nor arbitrary.[143] These considerations form part of the assessment of a breach of most substantive standards of protection such as National Treatment, Most-Favored Nation Treatment, Fair and Equitable Treatment, or even Expropriation. Hence, it seems that exception clauses do not contribute to the already existing regulatory space.[144] It has indeed been argued that *bona fide* regulations seeking to safeguard public welfare in a non-discriminatory manner and respectful of due process, which is precisely the rationale of exception clauses, would hardly require explicit treaty exceptions.[145]

More importantly, the overlap of legitimate regulatory powers available both under the substantive standards of protection and the exception clauses might actually be counterproductive. As treaty

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138 Vandevelde, *Rebalancing through Exceptions* (2013) 17(2) Lewis & Clark L. Rev., pp. 449-460 (454-455).

139 Henckels, *Scope Limitation or Affirmative Defence? The Purpose and Role of Investment Treaty Exception Clauses*, in Bartels and Paddeu (eds), *Exceptions in International Law* (2020), pp. 363-374 (374).

140 Foster, *Burden of Proof in International Courts and Tribunals* (2010) 29 Australian Yearbook of International Law, pp. 27-86 (40).

141 Henckels, *Scope Limitation or Affirmative Defence? The Purpose and Role of Investment Treaty Exception Clauses*, in Bartels and Paddeu (eds), *Exceptions in International Law* (2020), pp. 363-374 (372).

142 Article XX of the GATT requires a two-step analysis, first whether the particularly measure falls within the policy objectives of subparagraphs (a) to (j); second, whether the measure meets the chapeau of the article, which refers to the manner of implementation i.e. in a non-discriminatory nor abusive manner, see Moran, *The First Twenty Cases Under GATT Article XX: Tuna or Shrimp Dear?*, in Adinolfi, et al. (eds), *International Economic Law - Contemporary Issues* (2017), pp. 3-21 (5).

143 See, for instance, Israel-Japan BIT (2017), Article 15; Slovakia-Iran BIT (2016), Article 11; Australia-China FTA (2015), Article 9.8; Canada-Guinea BIT (2015), Article 18.

144 Legum and Petculescu, *GATT Article XX and International Investment Law*, in Echandi and Sauvé (eds), *Prospects in International Investment Law and Policy* (2013), pp. 340-362 (344, 352 ff).

145 Vandevelde, *Rebalancing through Exceptions* (2013) 17(2) Lewis & Clark L. Rev., pp. 449-460 (459).

obligations would be interpreted in their context and in light of the treaty's object and purpose,[146] tribunals may conclude that contracting parties wanted to shift their regulatory powers to the exception clauses, thereby reducing or narrowing their sovereign powers *vis-à-vis* the substantive standards of protection.[147] For instance, the *Bear Creek* tribunal concluded that the existence of a GATT-like exception clause in the applicable treaty entailed that 'no other exceptions from general international law or otherwise can be considered applicable.'[148] Certainly, such a conclusion is debatable, as pointed out by the dissenting arbitrator Philippe Sands.[149] However, states must be mindful that similar situations may occur, which might unintendedly impair the actual purpose of including exception clauses in IIAs.

Should contracting states intend to explicitly include and preserve their regulatory powers in IIAs, it is recommended that they combine exception clauses with clarifications regarding the scope of standards of protection.[150] Such extra caution would result in a more predictable interpretation of the legitimate exercise of a state's sovereign powers with respect to investment protection.

E. OTHER 'DEFENCES' A RESPONDENT MAY USE?

Respondent host states may advance arguments which seek neither to preclude the wrongfulness of the state conduct, nor to avoid responsibility. Particularly, they may request the reduction of the compensation owed (quantum reduction arguments), or they may submit a claim against the claimant investor (counterclaims).

With respect to **quantum reduction**, all defence arguments are centered around the claimant's behavior. For instance, illegality occurring during the operation of the investment might be a factor that the tribunal assesses on the merits or as part of the quantification of the damage.[151] Of particular importance are the arguments on contributory fault and the duty to mitigate damages,

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146 VCLT, Article 31(1).

147 Mitchell, Munro and Voon, *Importing WTO General Exceptions into International Agreements: Proportionality, Myths and Risks*, in Sachs, Johnson and Coleman (eds), *Yearbook on International Investment Law & Policy 2017* (2019), pp. 305-355 (para. 19.74). Similarly, Choudhary, *Much Ado About Nothing: The Case Against Replicating Article XX(g), GATT 1994 in International Investment Agreements* (2020) 23(1) Zeitschrift für Europarechtliche Studien ZEuS, pp. 195-223 (214).

148 *Bear Creek Mining Corporation v Peru*, ICSID Case No ARB/14/21, Award (30 November 2017), para. 473.

149 Id., Partial Dissenting Opinion of Professor Philippe Sands (12 September 2017), para. 41: '…the Majority has ruled…that Article 2201.1 of the FTA, which provides for a list of exceptions that fall within a State's legitimate exercise of its police powers, is exhaustive. I do not disagree with this analysis, but wish to make clear that my support for this conclusion is without prejudice to the application of Article 25 of the ILC Articles on State Responsibility, which deals with acts of Necessity…the clear operation of a lex specialis in a BIT does not have the effect (unless the BIT explicitly provides otherwise) of precluding the operation of Article 25, which continues to function as a "secondary rule of international law" operating even when an exception under the lex specialis is not available.'

150 Mitchell, Munro and Voon, *Importing WTO General Exceptions into International Agreements: Proportionality, Myths and Risks*, in Sachs, Johnson and Coleman (eds), *Yearbook on International Investment Law & Policy 2017* (2019), pp. 305-355 (paras. 19.111 ff).

151 Diel-Glior and Hennecke, *Investment in Accordance with the Law*, in Bungenberg et al. (eds), *International Investment Law: A Handbook* (2015), pp. 566-576 (575).

which find reflection in public international law.[152] Whilst the former presupposes a causal link between the injured party's behavior and the wrongful act, the latter presupposes a breach where the injured party did not alleviate the effects thereof.[153]

Regarding contributory fault, the *MTD* tribunal decided that the claimant should bear part of the damages (50%), given its lack of due diligence when making the investment.[154] Similarly, the *Occidental* tribunal reduced the damages by 25% for the claimant's failure to obtain ministerial authorizations before the transfer of contractual rights.[155] Regarding the duty to mitigate damages, the *EDF* tribunal held that the claimant had failed to mitigate its damage by selling the investment in unfavorable conditions. Thus, the value of the claimant's investment was reduced by 50%.[156]

To date, there is no globally accepted definition of **counterclaims** in international dispute settlement, but it seems rather undisputed that counterclaims are substantive claims of the respondent[157] that promote procedural/judicial economy.[158] However, the adjudicator must have (express or implicit) jurisdiction to decide upon them.[159] In investment arbitration, counterclaims have been successful in only in a handful of cases.[160] More often, investment tribunals have dismissed counterclaims for various reasons, including lack of jurisdiction, inadmissibility, or ultimately on the merits.[161]

Counterclaims are not *per se* defence arguments since their aim is neither to fend off claimants' claims by precluding wrongfulness or responsibility, nor to reduce any compensation. They rather seek independent relief for claimant's illegal actions. Yet, respondents raising counterclaims usually

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152 ARSIWA, Article 39; *Case Concerning the Gabčíkovo-Nagymaros Project (Hungary/Slovakia)*, Judgment, 25 September 1997, ICJ Reports (1997), 7 (para. 80).

153 Viñuales, *Defence Arguments in Investment Arbitration*, in Viñuales and Waibel (eds), *ICSID Reports: Volume 18* (2020), pp. 9-108, fn. 458.

154 *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Award (25 May 2004), paras. 242-243.

155 *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award (5 October 2012), para. 678.

156 *EDF International S.A., SAUR International S.A. and León Participaciones Argentinas S.A. v. Argentine Republic*, ICSID Case No. ARB/03/23, Award (11 June 2012), para. 1306 ff.

157 Berger, *Set-Off in International Economic Arbitration* (1999) 15(1) Arb. Int'l, pp. 53-84 (60); Kee, *Set-off in International Arbitration - What Can the Asian Region learn?* (2005) 1(2) Asian Int'l Arb. J., pp. 141-160 (146).

158 Antonopoulos, *Counterclaims Before the International Court of Justice* (2011), p. 10; Atanasova, Martínez Benoit and Ostřanský, *The Legal Framework for Counterclaims in Investment Treaty Arbitration* (2014) 31(3) J. Int'l Arb., pp. 357-392 (359).

159 Douglas, *The International Law of Investment Claims* (2009), para 488.

160 Popova and Poon, *From Perpetual Respondent to Aspiring Counterclaimant? State Counterclaims in the New Wave of Investment Treaties* (2015) 2 (2) BCDR Int'l Arb. Rev., pp. 223-260 (226). Vohryzek-Griest, *State Counterclaims in Investor-State Disputes: A History of 30 Years of Failure* (2009) 15(2) Revista Colombiana de Derecho Internacional, pp. 83-124 (86ff).

161 For a detailed analysis of counterclaims in investment arbitration see Alvarado-Garzón, *Environmental Counterclaims in Investment Arbitration: Deconstructing the Requirements of Jurisdiction, Connection and Cause of Action* (forthcoming). See also Chapter 5.1.4: Counterclaims by Respondent Host States.

request compensation. To the best of the author's knowledge, no successful counterclaim has exceeded the compensation awarded to the respective claimant. Thus, in the few cases a tribunal has upheld a counterclaim,[162] the practical effect has been the reduction of the compensation granted to the claimant, much like a set-off.

F. CONCLUSIONS

Defences in investment arbitration cover a wide range of arguments that the respondent host state may rely upon when facing an investment claim. Defences vary with regard to their availability, purpose and function. Thus, a comprehensive classification might remain elusive. In this context, a legally sound starting point is to distinguish between defences precluding wrongfulness and defences excluding responsibility. The end-result may be the same, namely the respondent host state avoiding liability *vis-à-vis* the claimant investor. However, the distinction between precluding wrongfulness and excluding responsibility has different connotations from a political point of view, as states tend to prefer their conduct to be deemed lawful, rather than excused. There are also important consequences for the burden of proof. This should be a crucial consideration for future treaty drafting, particularly, when states aim at preserving and buttressing their right to regulate.

Be that as it may, some defences may escape this distinction, for instance, given the malleable nature of treaty exception clauses or the rather practical effect of quantum reduction arguments. Accordingly, each defence argument must be treated independently from others and scrutinized on its own merit. Respondent host states certainly enjoy a variety of defences, but they must be mindful of the particularities of each argument. This contribution thus might be instrumental in this regard, providing an overview of the most common defence arguments in investment arbitration.

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[162] See, for instance, *Zeevi Holdings v. The Republic of Bulgaria and the Privatization Agency of Bulgaria*, Case No. UNC 39/DK, Award (25 October 2006); and *Elsamex, S.A. v. Republic of Honduras*, ICSID Case No. ARB/09/4, Award (16 November 2012).