
Managing the World Economy

The international economy has experienced a period of remarkable integration since the end of World War II. Simultaneously, states have created a complex and rapidly expanding body of law and a set of international institutions to both guide and encourage these developments. Hence, in recent years international economic law — the rules and institutions that affect international business transactions and govern economic relations among states — has become one of the largest and most vibrant fields of international law. Many scholars suggest that the vast majority of international legal work today consists of the interpretation and application of international economic law. As a result, students of international law can no longer ignore this field, particularly the law of international trade — the flow of goods across national borders — and investment — the flow of capital across national borders.

International economic law is in a period of significant change. These changes both reflect and shape larger transformations in global commerce and finance. Financial flows have been liberalized throughout the world; market forces now largely determine economic outcomes in many states; and U.S. economic dominance has given way to an emerging multipolar alternative, where prosperous industrialized polities such as the United States and European Union (EU) vie for power and influence with rapidly industrializing states such as Brazil, China, and India. More broadly, the international economy has entered a period termed “globalization,” marked by liberalized flows of goods, money, people, and ideas across national borders and heightened economic interdependence. At the same time, many issues previously regarded as purely domestic, such as environmental or labor laws, are now seen as having international economic dimensions.

In this chapter we explore three of the most important and difficult institutional and legal issues addressed by international economic law. First, we examine the interplay of law and politics in the resolution of international trade disputes and the development of the World Trade Organization’s (WTO) extraordinary dispute resolution process by focusing on the so-called banana war. Next, we explore the interface of economic and other social policies and the relationship of international economic law and domestic law through an in-depth study of trade and environment issues. Finally, we focus on the emerging law of foreign investment by examining investor-state arbitration and controversies over the ability to regulate foreign direct investment under conditions of severe economic stress. These materials will introduce you to many of the key principles and institutions that states use to manage the global economy.

I. PROMOTING INTERNATIONAL TRADE AND RESOLVING TRADE DISPUTES: THE BANANA WAR

Many of the principles animating today's global trading system can be understood as responses to the disastrous trade policies states used during the years leading to the Great Depression and World War II. During the 1920s and 1930s, many states subsidized exports, depreciated currencies, raised tariffs, and pursued other policies designed to increase exports and decrease imports. But these mercantilist policies prompted retaliatory actions from other trading states. Thus, after the United States raised its tariffs by enacting the Smoot-Hawley Act in May 1930, Australia, Canada, Cuba, France, Italy, Mexico, New Zealand, and Spain quickly raised their tariffs, and a number of other countries imposed import quotas. In the aggregate, these actions caused a dramatic reduction in international trade, which in turn contributed to the depth and length of the Great Depression. In the post-World War II era, states decided to use international law and institutions to help them avoid a repeat of the interwar experience.

The trade system was designed to address both economic and political problems. On the economic side, political leaders believed that, in the absence of trade restrictions, each state would specialize in the production of goods that it could make more efficiently than other states. The economic theory of comparative advantage teaches that such international specialization increases the efficiency of global production and markets, thereby producing greater trade and greater aggregate wealth. From this economic perspective, the purpose of trade rules is to liberalize markets and increase global welfare.

On the political side, the dynamic driving interwar trade policy can be understood as a "prisoner's dilemma." This is a game theoretic term for situations where two or more actors have incentives to cooperate (in this context, to reduce trade barriers to increase aggregate welfare) and incentives to "defect" from cooperation, or raise trade barriers, notwithstanding any harm this might cause to other states. From any particular state's perspective, the best situation is when that state alone defects (that is, where it raises trade barriers to keep out imported goods), but other states cooperate by lowering their trade barriers (permitting the first state to expand its exports). Of course, if every state were to choose to defect, then the global economy would be marked by high trade barriers and reduced economic wealth for all—precisely the situation states faced during the interwar years. The dilemma, then, is how to avoid the counterproductive outcomes that result when each state pursues its apparent self-interest. From this perspective, the purpose of international trade law and institutions is to help states avoid the prisoner's dilemma by increasing incentives to cooperate and by raising the costs of defection.

Thus, in the immediate postwar era there were compelling economic and political rationales for the creation of an international trade regime, and one of the UN's first tasks was to sponsor a series of negotiations over a charter for a proposed International Trade Organization (ITO). The ITO was to have responsibility for international trade and other international commercial matters. At the same time, at U.S. urging, states entered into separate negotiations for a tariff reduction treaty called the General Agreement on Tariffs and Trade (GATT). By 1947 negotiators had completed the GATT, although parts of the ITO Charter were still being negotiated.

The GATT was closely tied to the prospective ITO. Many GATT provisions were taken verbatim from the ITO Charter. More important, the GATT provided that “on the day on which the [ITO Charter] enters into force,” GATT’s provisions “shall be suspended and superseded by the corresponding provisions of the Charter.” The diplomats who negotiated the GATT were eager for it to come into force as quickly as possible. Thus, in 1947 eight GATT parties entered into the Protocol of Provisional Application, which provided that these states would apply GATT on a provisional basis from January 1, 1948.

By 1949, however, U.S. enthusiasm for the ITO had significantly diminished, due to a revival of isolationist sentiments, limited support from the business community, and a general disenchantment with international organizations. Without U.S. support, international efforts to create the ITO faltered, and the ITO Charter never entered into force. Thus, by default the GATT served for nearly 50 years as the principal mechanism governing international trade.

The GATT contains a series of rules designed to reduce government policies that distort trade and thus achieve the economic and political goals of its drafters. Most important, GATT contains two fundamental nondiscrimination rules. GATT Article I—the most-favored-nation (MFN) clause—bans discrimination among foreign country imports. Under this rule, any advantage (such as reduced tariffs) that a state extends to products imported from any of its trading partners must be extended to like products imported from all other GATT parties. An exception permits preferential tariff treatment to be extended to developing states in certain circumstances. GATT Article III contains the second nondiscrimination rule, called the national treatment obligation (NTO). This Article requires that once imported products from another GATT party have cleared customs, governments must treat them no less favorably than they do like domestic products. In addition, GATT Article XI prohibits, subject to certain exceptions, the use of quotas and other nontariff trade restrictions. Finally, GATT Article II permits the use of tariffs, but not in excess of agreed-upon levels. Many states have substantially reduced their tariffs through a series of GATT negotiating “rounds.”

In 1995 trading states entered into a series of agreements collectively called the Uruguay Round agreements. In addition to maintaining the basic GATT rules outlined above, these agreements created a new international organization, the WTO, and extended trade rules into several new areas, including services and intellectual property. As of January 2010, 153 states, including most of the industrialized world, were members of the WTO.

Given the breadth of WTO rules and the number of WTO members, the WTO system applies to over \$19 trillion, or about 90 percent, of international trade in goods and services per year. As a result, disputes frequently arise as to whether a state is complying with its WTO obligations. One of the Uruguay Round agreements—the Understanding on Rules and Procedures Governing the Settlement of Disputes (Dispute Settlement Understanding or DSU)—creates a complex system for resolving such disputes.

The WTO Director-General has called the DSU “the central pillar of the multilateral trading system and the WTO’s most individual contribution to the stability of the global economy.” As you read the materials that follow, consider whether the dispute settlement process is or should be primarily one of adjudication or one of negotiation; whether WTO panels do or should employ a deferential standard when reviewing national legislation; and whether the system adequately addresses the problem of noncompliance with adverse WTO rulings. More broadly, consider how to surmount the barriers to successful international cooperation in the trade area; the decision-making processes used in international trade bodies; and whether the institutional structures developed in the trade area are transferable to other areas of international law.

A. *The Problem*

World trade in bananas exceeds \$5.8 billion annually. Bananas are the planet's second most traded foodstuff, behind only coffee. Bananas come primarily from three areas: the Caribbean, Central and South America (Latin bananas), and the Philippines. Latin banana plantations are typically controlled by U.S.-based transnational corporations. They frequently cover several thousand acres and often use sophisticated irrigation, drainage, and highway systems. Caribbean island plantations are generally no larger than 12 acres and cannot realistically be expanded. Given superior technology and economies of scale, Latin bananas typically sell for 20 to 25 percent of the price of Caribbean bananas.

The European Community (EC) member states consume over 4 million tons of bananas annually — nearly 40 percent of the global banana market — and are the world's largest banana importers. The Europeans likely also have the most convoluted banana import regime on the planet. Pursuant to the 1989 Lomé IV treaty between the EC and a group of former European colonies in Africa, the Caribbean, and the Pacific (the ACP states), ACP bananas entered EC nations duty-free. But, before July 1, 1993, each EC member state had its own combination of tariffs, quotas, and import licensing regulations for non-ACP bananas.

As the EC moved toward a more unified common market, it attempted to create a unified banana regime. After two years of extensive negotiations, in February 1993 the EC adopted Regulation 404/93, a complex structured tariff and quota system to replace the various national regimes. In essence, the new regulation recognized four different categories of banana suppliers and created a complicated tariff and quota scheme for bananas from each category. The regulation afforded duty-free importation of ACP bananas for up to 30 percent of all European banana consumption. Up to 2 million tons of Latin bananas could be imported per year at a 20 percent tariff, while additional Latin bananas were subject to a 170 percent tariff. An even more complex regime governed the distribution of licenses to import bananas into the EC. This regime also favored ACP nations.

Latin countries complained that the EC regime cost them millions of dollars annually in lost sales. While the United States does not export bananas, it complained that this regime discriminated against U.S.-based banana distributors, such as Chiquita and Dole Foods, which grow bananas in Central America.

B. *GATT Dispute Settlement*

As noted above, the ITO Charter was supposed to supersede the GATT. Hence, the GATT's provisions on institutional matters, including dispute settlement, were skeletal at best. The GATT provides a right of consultation when one party alleges that another has failed to carry out its GATT obligations. It further provides that if consultations fail to settle matters, the dispute may be referred to the Contracting Parties (that is, all the GATT parties acting jointly), who "shall promptly investigate" and are authorized to make appropriate recommendations or to "give a ruling on the matter." In appropriately serious cases, the Contracting Parties may authorize "a Contracting Party or Parties" to retaliate by restricting trade from the offending party.

During the GATT's early years, GATT parties almost always addressed trade disputes through diplomatic means. By the early 1950s, GATT parties submitted disputes to "working parties," consisting of representatives of the disputing parties and other trade diplomats. Around 1955, GATT parties developed a practice of submitting disputes to

panels of three to seven experts. These experts were typically GATT delegates from neutral countries who would issue a "report" akin to a legal ruling on the merits of a complaint. Panels forwarded their reports to the GATT Council (that is, the executive committee of the full membership) for adoption. Panel reports had no official status unless and until adopted by the GATT Council.

This dispute resolution process had a number of features that, over time, proved problematic. Notably, a consensus rule governed each stage of this process. Hence, the allegedly noncomplying state had a right of veto at virtually every step of the process, from the appointment of a panel to the decision to adopt a panel report to a decision to authorize trade sanctions in response to noncompliance. Moreover, there were no set time periods for the various stages of the process, giving defending states the ability to delay — sometimes interminably — the proceedings. In addition, formal procedures for monitoring compliance with panel rulings were lacking. Finally, the consensus rule rendered remedial action to enforce compliance virtually impossible. Indeed, only once between 1948 and 1994 did the GATT Council authorize a prevailing state to retaliate or restrict trade from a noncompliant state.

Early panel reports often contained diplomatically vague language. Governments understood the implicit rulings, and losing governments nearly always complied with panel reports. This process worked in part because the GATT of the 1950s was essentially a small club of like-minded trade officials who shared a common understanding of GATT obligations.

During the 1960s, the GATT panel process fell into disuse. In part, this reflected a dramatic change in the GATT's membership, including a significant increase in the number of developing country members. In addition, developed states were frequently reluctant to litigate claims asserted by increasingly aggressive developing states, and used the consensus rules to block panel proceedings.

During the 1970s, GATT dispute settlement activity increased, reflecting in part an increased concern about the proliferation of nontariff trade barriers. While panels used the same procedures as before, in other ways it was not possible to turn back the clock:

At first, the GATT panels appointed in the 1970s tried to follow the nuanced diplomatic style of adjudication practiced in the 1950s. But the . . . "club" of the 1950s was gone, and in its place was a much more contentious membership of over eighty nations. . . . Meanwhile, political leaders in national capitals had begun to pay greater attention to GATT legal affairs, on the one hand questioning its assertion of legal authority over their trade policies, and at the very same time demanding more aggressive prosecution of GATT legal claims against others. The more these often contentious GATT legal proceedings fell under the political spotlight, the more difficult it became for panels of GATT diplomats to "finesse" their way to an acceptable conclusion in important legal disputes.

. . . The GATT Secretariat recognized that, in this new and more difficult setting, the dispute settlement procedure would need to rely more heavily on the authority of "law" itself. . . . And over the next decade . . . the panel procedure [produced] a string of quite sophisticated legal decisions resolving a number of very sensitive trade policy disputes. These successes stimulated governments to bring more legal conflicts to the GATT, with an ever-increasing degree of difficulty and political sensitivity. As it dealt with this growing caseload, the dispute settlement system also began to develop the substantive content of GATT law in a series of forward-looking legal precedents.

By the end of the 1980s, GATT had developed its dispute settlement procedure into a quite powerful legal instrument. In the decade as a whole the GATT procedure disposed of some 115 legal disputes, and by the end of the decade the annual volume of complaints was almost double that level. As the cases became more and more difficult, the number of failures increased, but at the end of the decade over 80 percent of the cases were still being successfully disposed of. To be sure, that rate of failure would certainly have been unacceptable for most advanced domestic legal systems. For an international legal institution, however, it was remarkably successful. Most important, it was successful in the view of the governments which participated in it. Indeed, the best measure of the success of the GATT disputes procedure by 1990 was the increasing number of complaints governments chose to bring before it and the increasing political sensitivity of the trade practices it was being asked to rule upon. . . .

Robert E. Hudec, *The New WTO Dispute Settlement Procedure: An Overview of the First Three Years*, 8 Minn. J. Global Trade 1, 7-8 (1999).

Notes and Questions

1. How could the GATT dispute resolution process resolve so many disputes over so many years given the virtual absence of legally binding enforcement powers?
2. Why would states create a dispute settlement system in which the losing party had the right to veto unfavorable decisions or the imposition of sanctions against it?
3. If you were a trade official for a GATT party, what procedural features of the GATT dispute settlement system would you seek to change? Do you think such changes would be politically viable?

C. Challenging the EC Banana Regime

Shortly before adoption of EC Regulation 404/93, five Central and South American nations requested creation of a GATT dispute resolution panel to examine the European banana regimes. The panel report (*Bananas I*), issued in June 1993, found that Europe's patchwork of preferences and different tariffs violated the GATT's ban on quantitative restrictions (quotas) and its MFN clause. However, this victory proved hollow. First, the report was never formally adopted by the GATT Council due to objections from the EC and ACP nations. Second, the various banana import regimes were terminated less than one month after the panel report was issued and were replaced by Regulation 404/93.

In 1993 the Latin American nations requested a second panel to determine the GATT consistency of the new EC banana regime. In January 1994 the second panel issued its report (*Bananas II*), finding that the new banana regime was GATT-inconsistent. In particular, the panel found that the tariff preferences granted the ACP in the new regime violated the GATT's MFN and national treatment obligations. Once again, however, the EC and ACP nations blocked adoption of the panel report. The EC argued that implementation of the panel report would cause dire political and economic consequences to ACP states and would violate the EC's obligations under the Lomé Convention.

In March 1994, the EC and four of the complaining parties negotiated the so-called Bananas Agreement. Colombia, Costa Rica, Nicaragua, and Venezuela agreed not to seek

adoption of the second panel report, and the EC agreed in effect to increase the number of bananas imported from those countries. Guatemala, one of the complainants, did not participate in this agreement, which the United States and Germany (Europe's largest consumer of bananas) also opposed.

As the EC's banana regime was being challenged at the GATT, a unilateral challenge to the regime was also developing. In September 1994, Chiquita Brands International, Inc. and the Hawaii Banana Industry Association filed a petition with the U.S. Trade Representative (USTR) under section 301 of the U.S. Trade Act of 1974, alleging that the Banana Agreement unlawfully discriminated against Chiquita bananas. Section 301 authorizes the USTR, after an investigation and consultations with a foreign government, to respond to foreign government acts, practices, or policies that are "unjustifiable," "unreasonable" or "discriminatory," and that burden or restrict U.S. commerce. The statute defines as "unreasonable" any foreign government act, policy, or practice that, although "not necessarily in violation of, or inconsistent with, the international legal rights of the United States, is otherwise unfair or inequitable." Section 301 authorizes the USTR to impose duties, quotas, or other trade restrictions on nations that engage in "unreasonable" acts.

In response to the collective pressure of the adverse panel reports, splits within the EC, and the Section 301 proceedings, the EC and ACP nations sought a GATT "waiver." GATT Article XXV(5) provides that "in exceptional circumstances" the GATT parties can "waive an obligation imposed upon a contracting party." At the final GATT Council meeting in December 1994, the Contracting Parties approved a five-year waiver from Article I's MFN clause for Lomé IV's trade provisions. (Under the GATT, a waiver could be granted by a two-thirds majority vote of the Contracting Parties, while the WTO agreements, which took effect January 1, 1995, require a three-fourths majority vote to approve a waiver). The waiver reads, in part:

Subject to the terms and conditions set out hereunder, the provisions of paragraph 1 of Article I of the General Agreement shall be waived, until 29 February 2000, to the extent necessary to permit the European Communities to provide preferential treatment for products originating in ACP states as required by the relevant provisions of the Fourth Lomé Convention, without being required to extend the same preferential treatment to like products of any other contracting party.

In the meantime, USTR was investigating the EC banana regime and on January 9, 1995, announced its preliminary determination that the EC regime was adversely affecting U.S. economic interests. USTR then entered into months of inconclusive negotiations with the Europeans. In September, the United States announced that it, along with Guatemala, Honduras, and Mexico, would challenge the EC banana regime in the new WTO. This became known as the *Bananas III* dispute.

ACP nations strongly opposed the filing of this action, arguing that the survival of thousands of small banana producers — and even the economy of several Caribbean islands — were at issue. They pointed out that in St. Vincent, for example, some 70 percent of the population depends directly or indirectly upon income from the bananas trade. More broadly, over 60 percent of export income for the Windward Islands (Dominica, Grenada, St. Lucia, and St. Vincent and the Grenadines) comes from the bananas trade. Caribbean growers argued that if they lost preferential access to European markets for legitimate goods like bananas, they would have little option but to turn to illegitimate goods, such as illegal drugs.

D. *The Evolution of Dispute Settlement in the Trade Regime*

When the Uruguay Round negotiations started in 1986, GATT governments sought only minor procedural changes in dispute settlement procedures. In 1988 GATT parties rejected efforts to change the consensus principle that gave the losing party a veto over adverse rulings. However, less than a year later, GATT parties agreed to a dramatically enhanced dispute resolution system in the DSU. The DSU essentially reverses the GATT consensus rule; under the DSU, requests for a panel, requests to adopt a panel report, and requests for authorization of sanctions in cases of noncompliance are all automatically granted unless there is a consensus by all WTO members sitting as the Dispute Settlement Body (DSB) *against* such a request. In addition, the DSU provides for strict deadlines at each stage of the proceedings. The DSU grants losing parties a “reasonable period” within which to comply with panel rulings, a period that can be set by WTO arbitrators. Finally, if a party refuses to comply, it is supposed to negotiate a mutually acceptable agreement with the prevailing party; if this is not possible, the winning party can receive DSB authorization for trade retaliation against the losing party by, for example, raising tariffs.

Given the considerably increased importance of panel reports, the DSU also creates a standing Appellate Body, to which parties can appeal points of law. The same WTO reverse consensus rule applies to Appellate Body reports — they automatically enter into effect unless the entire WTO membership decides by consensus not to adopt the report. This appellate procedure is unique in the history of interstate dispute resolution.

What caused this dramatic change? The immediate precipitating event was apparently the considerable strengthening of Section 301 by major trade legislation enacted in 1988. The new legislation created “Super 301,” which requires USTR to identify “major [foreign government] barriers and trade distorting practices, the elimination of which are likely to have the most significant potential to increase United States exports.” After identifying these practices, USTR is directed to persuade the other government to eliminate the unfair barriers or provide the United States with compensation. If the other government is unwilling to accede to U.S. demands, USTR may take retaliatory trade action.

Other governments viewed the new legislation as an unacceptable unilateral attempt by the United States to judge their trade practices and called a special GATT meeting to demand a change in U.S. policy. The United States argued that these unilateral procedures were necessary because GATT dispute settlement was too cumbersome and too weak to protect U.S. trade interests adequately. Eventually, the outlines of a global bargain emerged. In addition to compulsory jurisdiction, the reverse consensus rule, strict time limits, and provisions for sanctions in cases of noncompliance, the DSU provides:

Article 23

Strengthening of the Multilateral System

1. When Members seek the redress of a violation of obligations . . . under the [WTO] agreements . . . they shall have recourse to, and abide by, the rules and procedures of this Understanding.
2. In such cases, Members shall:
 - (a) not make a determination to the effect that a violation has occurred . . . except through recourse to dispute settlement in accordance with the rules and procedures of this Understanding. . . .

- (b) follow the procedures set forth in [this agreement] to determine the level of suspension of concessions or other obligations and obtain DSB authorization in accordance with those procedures before suspending concessions or other obligations . . . in response to the failure of the Member concerned to implement [panel or Appellate Body] recommendations and rulings. . . .

E. Testing the WTO's Dispute Settlement System

In May 1997 the *Bananas III* panel report held that the EC regime was inconsistent with a number of WTO provisions and not authorized by the WTO waiver, which covered only the EC's MFN obligations. However, obtaining a determination on the merits of the EC's banana regime proved to be the start, rather than the finish, of WTO dispute resolution proceedings. The DSU provides losing parties with a "reasonable period of time" to change their law, but the United States and the EC disagreed over how long the EC should have to change its bananas regime. The DSU provides for binding arbitration in these circumstances, and an arbitrator granted the EC until January 1, 1999, to implement the panel's report and recommendations. In July 1998 the EC adopted a new bananas regulation to take effect on January 1, 1999. However, the United States argued that the new system would also be WTO-inconsistent, that the EC would therefore not be in compliance with the *Bananas III* report, and that the United States would impose trade sanctions effective February 1. The Europeans responded that under DSU Article 23, "[n]o member has the right to unilaterally determine, without recourse to [WTO procedures], whether another member is in compliance with WTO rules," and that any U.S. sanctions would be challenged at the WTO. The United States countered that the EC position would permit a recalcitrant party to enact an endless series of WTO-inconsistent measures, and thereby escape trade sanctions and defeat the prevailing party's automatic right to retaliate against noncompliant parties.

1. The DSU: The Death of Unilateralism?

From the U.S. perspective, the ongoing bananas dispute centered upon a discriminatory import regime and European noncompliance with multiple panel rulings. From the European perspective, the conflict was evolving into a dispute over the legality of unilateral U.S. trade actions, particularly those taken pursuant to Section 301. This law had long been a flash point in trans-Atlantic relations, and the Europeans believed that the DSU had been its death knell. Nevertheless, the United States was threatening unilateral action in this, and other, trade disputes. Hence, in a March 1999 proceeding formally unrelated to the bananas litigation, the Europeans challenged Section 301. Six months later the panel issued its report. Relevant excerpts follow:

United States — Sections 301-310 of the Trade Act of 1974

WT/DS152/R (1999)

7.2 The EC claims that by adopting, maintaining on its statute book and applying Sections 301-310 of the 1974 Trade Act after the entry into force of the Uruguay Round Agreements, the US has breached the historical deal . . . between the US and other Uruguay Round participants . . . consist[ing] of a trade-off between, on the one hand, the practical certainty of adoption by the Dispute Settlement Body ("DSB") of panel and

Appellate Body reports and of authorization for Members to suspend concessions . . . and, on the other hand, the complete and definitive abandoning by the US of its long-standing policy of unilateral action. . . .

THE MEASURE IN QUESTION AND THE PANEL'S GENERAL METHODOLOGY

7.28 . . . [I]n examining the relevant provisions of Sections 301-310 we first look at the statutory language itself, severed from all other elements of the law. We then look at the other elements of Sections 301-310 which, in our view, constitute an integral part of the Measure in question and make our final evaluation based on all elements taken together. . . .

7.59 The text of [DSU] Article 23.1 is simple enough: Members are obligated generally to (a) have recourse to and (b) abide by DSU rules and procedures. These rules and procedures include most specifically in Article 23.2(a) a prohibition on making a unilateral determination of inconsistency prior to exhaustion of DSU proceedings. . . .

7.61 . . . In each and every case when a determination [of GATT inconsistency] is made [by USTR under Section 301] while DSU proceedings are not yet exhausted, Members locked in a dispute with the US will be subject to a mandatory determination by the USTR under a statute which explicitly puts them in that very danger which Article 23 was intended to remove. . . .

7.94 The more effective and quasi-automatic dispute settlement system under the WTO has often been heralded as one of the fundamental changes and major achievements of the Uruguay Round agreements. . . . If individual economic operators cannot be confident about the integrity of WTO dispute resolution and may fear unilateral measures outside the guarantees and disciplines which the DSU ensures, their confidence in each and every of the substantive disciplines of the system will be undermined as well. The overall systemic damage and the denial of benefits would be amplified accordingly. The assurances thus given under the DSU may, in our view, be of even greater importance than those provided under substantive WTO provisions. . . .

7.96 Consequently, the statutory language of Section 304* — by mandating a determination before the adoption of DSB findings and statutorily reserving the right for this determination to be one of inconsistency — must be considered presumptively to be inconsistent with the obligations in Article 23.2(a). . . .

7.98 In the previous analysis we have deliberately referred to the "statutory language". . . . The Measure in question includes statutory language as well as other institutional and administrative elements. To evaluate its overall WTO conformity we have to assess all of these elements together. . . .

7.110 [A Statement of Administrative Action (SAA) accompanied the US legislation implementing the results of the Uruguay Round submitted by the President to Congress. The SAA states:]

This Statement . . . represents an authoritative expression by the Administration concerning its views regarding the interpretation and application of the Uruguay Round agreements, both for purposes of U.S. international obligations and domestic law. Furthermore, the Administration understands that it is the expectation of the Congress that future Administrations will observe and apply the interpretations and commitments set out in this Statement. . . .

*Section 304 directs the USTR to determine whether any U.S. rights are being denied under any trade agreement, or whether a foreign government act, policy, or practice is unjustifiable or unreasonable. If so, section 304 also directs the USTR to determine what action, if any, to take. Finally, Section 304 sets time limits for these determinations. These time limits are, in certain cases, shorter than the time limits used in WTO dispute resolution. — EDS.

7.112 [The SSA also states:] Although it will enhance the effectiveness of section 301, the DSU does not require any significant change in section 301 *for investigations that involve an alleged violation of a Uruguay Round agreement or the impairment of U.S. benefits under such an agreement. In such cases, the Trade Representative will:*

- invoke DSU dispute settlement procedures, as required under current law;
- **base any section 301 determination that there has been a violation or denial of U.S. rights under the relevant agreement on the panel or Appellate Body findings adopted by the DSB;**
- following adoption of a favorable panel or Appellate Body report, allow the defending party a reasonable period of time to implement the report's recommendations; and
- **if the matter cannot be resolved during that period, seek authority from the DSB to retaliate.**

This official statement in the SAA — in particular, the commitment undertaken in the second bullet point — approved by the US Congress in the expectation that it will be followed by future US Administrations, is a major element in our conclusion that the discretion created by the statutory language permitting a determination of inconsistency prior to exhaustion of DSU proceeding has effectively been curtailed. . . .

US STATEMENTS BEFORE THIS PANEL

7.115 . . . **In response to our very insistent questions, the US explicitly, officially, repeatedly and unconditionally confirmed the commitment expressed in the SAA namely that the USTR would “ . . . base any section 301 determination that there has been a violation or denial of U.S. rights under the relevant agreement on the panel or Appellate Body findings adopted by the DSB” . . .**

7.122 The representations and statements by the representatives of the US . . . were solemnly made, in a deliberative manner, for the record, repeated in writing and confirmed in the Panel's second hearing. . . .

7.125 **Accordingly, we find that these statements . . . express the unambiguous and official position of the US representing, in a manner that can be relied upon by all Members, an undertaking that the discretion of the USTR has been limited so as to prevent a determination of inconsistency before exhaustion of DSU proceedings. . . .**

7.126 The aggregate effect of the SAA and the US statements made to us is to provide the guarantees, both direct to other Members and indirect to the market place, that Article 23 is intended to secure. **Through the SAA and the US statements . . . it is now clear that under Section 304 . . . the USTR is precluded from making a determination of inconsistency contrary to [DSU] Article 23.2(a). . . . It of course follows that should the US repudiate or remove in any way these undertakings, the US would incur State responsibility since its law would be rendered inconsistent with the obligations under Article 23. . . .**

Notes and Questions

1. Are you persuaded by the panel's analysis? Is the Section 301 panel deciding that the U.S. statements to the panel were legally binding? If so, is this consistent with the principles governing the binding effect of unilateral statements developed in the *Eastern Greenland* and *Nuclear Tests* cases discussed in Chapter 2?

Given the panel's reliance on the Administration's representations to Congress in the SAA, is it relevant that USTR Mickey Kantor testified before Congress in 1994 that

some countries have even tried to claim that the WTO will restrict the ability of the United States to use Section 301 because it requires a member to abide by the [dispute settlement] rules and procedures when it seeks to redress a violation of the WTO. There is however absolutely no basis for such a claim.

2. Is Section 301 consistent with the text or structure of the DSU? Is it obsolete in a post-Uruguay Round world? Or is it a legitimate form of "civil disobedience" that can achieve change in the international trading system and pressure recalcitrant foreign governments to remove barriers to trade?

One empirical study of Section 301 analyzed some 72 cases brought between 1975 and 1994 and found that about half the time the United States achieved its negotiating objectives. Another examined 77 cases between 1975 and 1990 and found that trade liberalization occurred in about one-third of the cases, and that in eight instances the United States imposed trade measures against the target country. Should Section 301's "success" rate bear on the desirability or legality of statutes like this?

3. In the course of the dispute over the WTO consistency of Section 301, the United States argued that it had always applied Section 301 in a WTO-consistent manner. The panel invited the EC to submit evidence to the contrary. The panel refused to make a "conclusive finding" on this issue but noted that "the evidence submitted to us [was insufficient] to overturn the U.S. claim" that its use of Section 301 was WTO-consistent.

2. Responding to Noncompliance

In the aftermath of the *Bananas III* ruling and adoption of the new EC banana regime, the United States and the EC bitterly contested whether the United States had a right to request immediate DSB authorization to impose sanctions under Article 22 or whether a WTO panel first had to find the new regime WTO-inconsistent under Article 21.5. Relevant provisions of the DSU provide:

Article 21

Surveillance of Implementation of Recommendations and Rulings

1. Prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members. . . .

5. Where there is disagreement as to the [GATT] consistency . . . of measures taken to comply with the [panel's] recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original panel. . . .

Article 22

Compensation and the Suspension of Concessions

2. If the Member concerned fails to bring the measure found to be [GATT] inconsistent . . . into compliance therewith or otherwise comply with the [panel's] recommendations and rulings . . . such Member shall, if so requested . . . enter into negotiations with [the prevailing party] with a view to developing mutually acceptable compensation. If no satisfactory compensation has been agreed within [a specified time], [the prevailing party] may request authorization from the DSB to suspend the application to the Member concerned of concessions or other obligations under the covered agreements. . . .

4. The level of the suspension of concessions or other obligations authorized by the DSB shall be equivalent to the level of the nullification or impairment. . . .

6. When the situation described in paragraph 2 occurs, the DSB, upon request, shall grant authorization to suspend concessions or other obligations . . . unless the DSB decides by consensus to reject the request. However, if the Member concerned objects to the level of suspension proposed . . . the matter shall be referred to arbitration. . . . Concessions or other obligations shall not be suspended during the course of the arbitration.

7. The arbitrator . . . shall determine whether the level of such suspension is equivalent to the level of nullification or impairment. . . . The parties shall accept the arbitrator's decision as final. . . .

This dispute over whether the United States could proceed immediately to trade sanctions or had first to obtain a ruling that the new banana regulation was WTO-inconsistent unfolded in various stages. In December 1998, Ecuador, the world's largest banana exporter, requested formation of an Article 21.5 panel to examine the WTO consistency of the new EC regulation. In a highly unusual request, the EC asked for creation of an Article 21.5 panel as well. The following month the United States requested authorization under Article 22.2 to raise tariffs in the amount of \$520 million on EC products ranging from Italian pecorino cheese to Scottish cashmere sweaters. The EC responded by saying that this figure was inflated and, pursuant to Article 22.6, requested arbitration on the level of concessions requested by the United States.

Meanwhile, the broader WTO membership weighed in. Many governments claimed that EC noncompliance challenged the effectiveness of the WTO dispute system. Others countered that U.S. unilateralism posed a greater threat to the system. After weeks of backroom negotiations, on February 1 the Chair of the DSB offered the following self-described "suggest[ion]":

1. A number of delegations have highlighted the lack of clarity in how Articles 21.5 and 22 should be interpreted and the sequence in which they should be applied. I believe that many of these concerns are legitimate, but we face the problem of how to solve our problem in this dispute today. . . . I think that the best approach is to proceed by separating the Bananas case from the more general systemic issues. The solution to the Bananas matter *would be totally without prejudice* to future cases and . . . the systemic issue of the relationship between Articles 21.5 and 22. . . .

3. As to Bananas, the original panel is now engaged in two Article 21.5 proceedings. . . . [A]ssuming the EC makes a request for arbitration under Article 22.6, the same individuals could be given the task of arbitrating the level of suspension. . . . There remains the problem of how the panel and the arbitrators would coordinate their work, but as they will be the same individuals, the reality is that they will find a logical way forward, in consultation with the parties. . . .

4. As to the systemic issues concerning the relationship of Articles 21.5 and 22, they must be resolved expeditiously. . . . I will propose to the Chairman of the General Council that this matter be taken up by that body. . . .

Both the Article 21 and the Article 22 requests were sent to the original panelists. Under WTO rules, the Article 22 arbitration was to be completed by March 2 while the Article 21 panels were to announce their decisions by April 12. However, on March 2, the Article 22 arbitrators announced that they needed additional information before issuing a ruling. The following day, the United States announced that it was, in effect, raising tariffs on specific EC goods pending a final WTO decision on its Article 22 request.

On April 6, 1999, the Article 21.5 panels issued their reports and, simultaneously, the Article 22 arbitrators issued their award. The Article 21.5 panel requested by Ecuador concluded that various aspects of the EC's bananas regime still discriminated against Latin bananas and therefore were "inconsistent with the EC's obligations" under various WTO provisions. The Article 21.5 panel initiated by the EC rejected the EC's request for a finding that:

... the new EC [banana] regime ... adopted in order to comply with the recommendations and rulings of the [panel and Appellate Body] had to be deemed ... to be in conformity with the WTO covered agreements so long as those original parties had not successfully challenged the new EC regime under the relevant dispute settlement procedures of the WTO.

The EC did not appeal either panel decision.

The Article 22 arbitrators held, as the United States had argued, that they had the authority to rule on the WTO-consistency of measures taken to comply with a panel ruling.

It would be the WTO-inconsistency of the revised EC regime that would be the root cause of any nullification or impairment suffered by the United States. Since the level of the proposed suspension of concessions is to be equivalent to the level of nullification or impairment, logic dictates that our examination as Arbitrators focuses on that latter level before we will be in a position to ascertain its equivalence to the level of the suspension of concessions proposed by the United States.

The arbitrators concluded that the new EC banana regime was WTO-inconsistent and that the United States could retaliate in an amount of \$191.4 million per year. On April 19 the United States requested and received DSB authorization to suspend \$191.4 million worth of concessions. To do so, the United States imposed 100 percent customs duties on designated items from the EC.

In the meantime, in a formally separate proceeding, the EC challenged the U.S. decision to raise tariffs on selected imports from Europe in March, prior to the release of the arbitrators' award. A WTO panel made several relevant determinations. First, since DSU Article 23 requires WTO members to have recourse to and abide by DSU rules and procedures when they want to retaliate against alleged WTO noncompliance, sanctions imposed prior to a WTO finding of noncompliance violated Article 23. Second, the imposition of sanctions prior to the release of the Article 22 arbitrators' award violated Article 22, which states that "concessions or other obligations shall not be suspended during the course of the arbitration."

Finally, addressing the underlying doctrinal dispute of whether the United States could move immediately for authorization to impose sanctions under Article 22 or whether it first had to use the Article 21 process, the panel noted that while Article 21.5 provides that "where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures," it did not specify which procedures should be used. The panel agreed with the United States that an Article 22 procedure could be used and rejected the EC's argument that an Article 21.5 procedure had to be used. However, the panel held that the United States nevertheless violated Article 21.5 by imposing sanctions before any WTO body had held that the EC's implementing measures were WTO-inconsistent.

Both sides appealed this report. On the key doctrinal question of whether an Article 21.5 finding of noncompliance was a prerequisite to the imposition of sanctions, the Appellate Body found that the panel had improperly considered the United States's April 19th sanctions, imposed after the Article 22 award was issued. As the April sanctions were

not properly before the panel, its conclusion that an Article 22 proceeding can be used to satisfy the Article 21.5 requirements “ha[s] no legal effect.” The Appellate Body continued:

91. In coming to this conclusion, we are cognizant of the important systemic issue of the relationship between Articles 21.5 and 22 of the DSU . . . and [that] the relationship between these two provisions of the DSU has been the subject of intensive and extensive discussion among Members of the WTO. . . .

92. In so noting, we observe that it is certainly not the task of either panels or the Appellate Body to amend the DSU. . . . Only WTO members have the authority to amend the DSU. . . . [T]he task of panels and the Appellate Body in the dispute settlement system of the WTO is “to preserve the rights and obligations of Members . . . and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law.” Determining what the rules and procedures of the DSU ought to be is not our responsibility nor the responsibility of the panels; it is clearly the responsibility solely of the Members of the WTO.

United States — Import Measures on Certain Products from the European Communities, WT/DS165/AB/R (2000).

On April 11, 2001, the United States and the EU reached an agreement to resolve the banana dispute. The EU agreed to eliminate its quotas and to implement a tariff-only system by 2006. On July 1, 2001, the EU instituted a new interim system for licensing banana imports that effectively increased the number of Latin bananas imported into Europe at the expense of ACP bananas. On the same date, the United States suspended the trade measures it had imposed upon the EU since 1999.

Ecuador opposed the new agreement, which it characterized as “flagrantly WTO incompatible.” Ecuador threatened a WTO challenge and entered into negotiations with the Europeans. A few weeks later, the parties reached an agreement providing for an increase in Ecuador’s share of exports to Europe in exchange for Ecuador’s support for the U.S.-EC agreement. In December 2001, WTO members adopted a waiver covering the European quota for ACP bananas during the interim period before the Europeans moved to a tariff-only system. An annex to the waiver states that the new system “should result in at least maintaining total market access” for Latin American banana suppliers.

In 2005, the EU set a tariff at 230 euros per ton. Latin American exporters successfully challenged this rate as failing to provide them the same level of access to the European market previously agreed to. Thereafter, the EU lowered its tariff to 176 euros/ton but maintained duty-free access for 775,000 tons of ACP bananas. Ecuador and the United States successfully challenged this quota in WTO dispute proceedings and, in a November 2008 report, the Appellate Body upheld this finding.

As the various WTO disputes were proceeding, the Latin exporters and the EU tried to reach an agreement on an acceptable tariff rate, with WTO Director-General Pascal Lamy personally serving as mediator. In July 2008, the EU, Colombia, Costa Rica, Ecuador, Guatemala, and Panama reached an apparent agreement. However, the EU claimed that the banana deal was contingent upon a successful conclusion to the Doha negotiations, and when the Doha talks collapsed in July 2008, the EU refused to conclude the accord. The parties continued their negotiations and, with the assistance of the Director-General, finally reached a deal in December 2009 that provides for a tariff reduction to 114 euros/ton as well as provides 200 million euros in financial assistance to ACP producers. In addition, under a series of Economic Partnership Agreements that the EU entered into with ACP states, the EU would have the right to maintain duty-free access to ACP bananas.

Notes and Questions

1. The chart that follows summarizes the litigation over the EC bananas regime and related issues covered in this chapter.

<i>Complainant(s)</i>	<i>Respondent</i>	<i>Type of Proceeding</i>	<i>Issue</i>	<i>Holding</i>
Colombia, Costa Rica, Guatemala, Nicaragua, Venezuela	EC	GATT dispute resolution	GATT consistency of various European banana regimes	European regimes violate MFN and ban on quotas June 1993
<i>(Bananas I)</i>				
Colombia, Costa Rica, Guatemala, Nicaragua, Venezuela	EC	GATT dispute resolution	GATT consistency of EC Regulation 404/93	Regulation violates MFN and NTO obligations January 1994
<i>(Bananas II)</i>				
Ecuador, Guatemala, Honduras, Mexico, U.S.	EC	WTO dispute resolution	WTO consistency of EC Regulation 404/93	Regulation inconsistent with WTO obligations, not authorized by GATT waiver May 1997
<i>(Bananas III)</i>				
Ecuador, Guatemala, Honduras, Mexico, U.S.	EC	WTO Article 21 arbitration	Length of time for EC to change Regulation 404/93	EC given until January 1, 1999 January 1998
EC	U.S.	WTO dispute resolution	WTO consistency of section 301	Statutory language is presumptively inconsistent, but SAA and U.S. statements before panel limiting use of statute render statute not WTO-inconsistent September 1999

<i>Complainant(s)</i>	<i>Respondent</i>	<i>Type of Proceeding</i>	<i>Issue</i>	<i>Holding</i>
EC		WTO Article 21.5 proceedings	WTO consistency of EC's January 1, 1999 banana regime	Rejects EC request to find new regime WTO-consistent. April 1999
Ecuador	EC	WTO Article 21.5 proceedings	WTO consistency of EC's January 1, 1999 banana regime	January 1, 1999, regime is inconsistent with EC's WTO obligations April 1999
U.S.	EC	WTO Article 22.6 arbitration	1. Can Article 22 arbitrators determine the WTO consistency of January 1, 1999 banana regime? 2. Did U.S. request excessive level of retaliatory trade sanctions?	1. Article 22 arbitrators can rule on WTO consistency of losing party's implementation measures 2. U.S. request was excessive and is reduced to \$191.4 million per year April 1999
EC	U.S.	WTO dispute resolution	WTO consistency of U.S.'s unilateral trade sanctions against the EC on March 3	1. Unilateral sanctions violate Article 23 2. Unilateral sanctions violate Article 22 3. Unilateral sanctions violate Article 21.5 July 2000
U.S. (Appellant)	EC (Appellee)	WTO Appellate Body	WTO consistency of U.S.'s unilateral trade sanctions against the EC on March 3	1. Upholds panel determination that unilateral sanctions violate Article 21.5 2. Vacates panel determination that unilateral sanctions violate Article 22 as question was not properly before panel December 2000

<i>Complainant(s)</i>	<i>Respondent</i>	<i>Type of Proceeding</i>	<i>Issue</i>	<i>Holding</i>
Ecuador and U.S.	EC	WTO Article 21.5 proceedings	Consistency of EC banana tariff of 176 euros/ton	AB upholds panel finding that duty-free tariff quota for ACP states is WTO-inconsistent November 2008

2. Who won the banana war? The United States invested substantial legal resources and diplomatic capital over many years, yet the United States exports no bananas. Moreover, during the course of the bananas dispute, the EC challenged certain provisions of U.S. tax laws that distinguish between U.S. and foreign companies in the taxation of certain types of income. Many U.S. officials believe that the EC filed the tax case in retaliation for the bananas case. In October 1999, a WTO panel held that the tax breaks were WTO-inconsistent. In November 2000, the United States enacted new tax provisions in response to the panel report.

However, the EC argued that the new law was WTO-inconsistent and sought authorization to impose over \$4 billion per year in punitive tariffs against U.S. goods. The United States and EC agreed that the parties would submit the WTO compliance of the new law to an Article 21.5 panel. In August 2001, a WTO panel determined that the new U.S. tax law was WTO-inconsistent. In January 2002, the Appellate Body affirmed this decision.

The United States challenged the EC request for \$4 billion of trade sanctions as excessive, but in August 2002, an Article 22 arbitrator rejected the United States's arguments and approved the EC's request. In May 2003, the DSB authorized the EC to impose up to \$4 billion in tariffs against U.S. goods; in March 2004, the EC began to impose additional tariffs of 5 percent on selected U.S. goods, and increased the tariffs by 1 percent each subsequent month.

In October 2004, the United States replaced the offending law with a new law and, in response, in January 2005, the EC decided to lift its punitive tariffs. However, shortly thereafter, the EC challenged provisions of the new law in WTO dispute proceedings. In September 2005, a WTO compliance panel ruled that certain "transition and grandfathering clauses" in the new law were WTO-illegal and, in February 2006, the Appellate Body affirmed. The EC stated that it would reimpose sanctions within 90 days unless the United States fully complied with the Appellate Body ruling. In May 2006, days before the EC sanctions were to take effect, the United States passed a tax bill repealing most of the WTO-inconsistent measures, and the EC announced it would suspend its sanctions.

3. The banana dispute also illustrates the interplay of domestic and international politics in the trade area. Recall that the U.S. challenge to the EC's banana regime was triggered by a Section 301 filing by Chiquita. Chiquita was also very active in domestic trade politics. In the 2000 election cycle, Chiquita's top executive, Carl H. Linder, and American Financial Group, which owns 36 percent of Chiquita, gave \$1.03 million to Republicans and \$676,750 to Democrats. Chiquita also hired the brother of the White

House Chief of Staff to lobby the Clinton Administration on trade issues. The U.S.-EC banana deal allocated banana import licenses based in part on how they had been allocated between 1994 and 1996, a period when Chiquita dominated the European market. A spokesperson for rival Dole Food Company complained that Dole "got sold up the river."

Is the banana dispute a dispute between the U.S. and European governments, or is it more a battle among large multinational corporations for the European banana market? Did U.S. trade policy reflect the national interest or a particular corporate interest?

4. After prevailing in April 1999 its Article 21.5 action, in November 1999 Ecuador requested authorization to suspend concessions to the EC in the amount of \$450 million. The EC contested this figure, and the issue went to an Article 22 arbitration. In March 2000 the arbitrators found that Ecuador could suspend concessions in the amount of \$201.6 million. Thereafter, Ecuador and the EC were unable to negotiate a mutually acceptable agreement, and in May 2000, Ecuador requested, and received, WTO authorization to suspend concessions in the amount of \$201.6 million.

In its request, Ecuador argued that the imposition of higher tariffs on imported goods from the EC would harm its domestic industries, which are dependent upon imported capital goods and raw materials. Hence, WTO parties authorized Ecuador to retaliate by suspending intellectual property protection and wholesale distribution rights for EC goods and services providers. This authority was granted pursuant to a DSU provision allowing retaliation outside the sector of the measure at issue where it is not "practicable or effective" to impose sanctions in that sector (here, the sale of goods). These actions represented the first time that the WTO had authorized "cross-retaliation" outside the goods sector. Are retaliatory trade barriers a sensible remedy for the WTO to authorize?

5. Note that the WTO dispute system does not permit the award of damages for economic losses suffered before issuance of the panel report. What is the logic behind such a system? What incentive does this provide to states considering the adoption of WTO-inconsistent measures? Given that complainants absorb the considerable cost of litigating WTO disputes and, if successful, either share the benefits of the elimination of the offending measure with other states or impose (welfare-reducing) trade restrictions, what is the incentive to file a WTO action?

6. Is the DSU a success? States submitted some 298 disputes to the GATT's dispute resolution processes over nearly 50 years. Between January 1, 1995, when the WTO came into existence, and September 30, 2009, WTO members notified some 399 matters to the WTO. WTO parties have adopted 117 panel and Appellate Body reports.

The compliance issues presented in the bananas dispute were, for the most part, issues of first impression. In subsequent disputes raising compliance issues, the WTO members involved have generally reached agreements affirming the need for an Article 21.5 panel to rule on whether a member has complied with a panel report before the complaining party can suspend concessions. As of autumn 2009, WTO members had requested a panel or the Appellate Body to rule on compliance in 34 disputes. Many of the disputes that raise compliance issues, such as the bananas dispute, involve multiple complainants. The WTO had authorized trade retaliation against noncompliant parties in less than 20 disputes.

II. BALANCING TRADE AND THE ENVIRONMENT: THE *SHRIMP-TURTLE* DISPUTE

Trade and environment issues loomed large in the public protests at the WTO's meeting in Seattle in 1999 and at subsequent international economic meetings. The trade and environment debate covers a number of issues: will the increased economic activity caused by expanded trade create pollution spillovers from one state to another; or lead to the unsustainable use of natural resources? Will governments use rules contained in trade agreements to override domestic or international environmental laws? Can states restrict trade to encourage other states to address regional or global environmental problems? Finally, beneath much of the trade and environment debate lies the difficult question of whether states with lower environmental standards enjoy competitive advantages in international markets and, if so, what can or should be done about this.

In this section, we explore the trajectory of WTO jurisprudence addressing these controversial issues. As you review the materials in this section, consider how international bodies can distinguish between environmental measures that protect inefficient domestic industries from those that protect important environmental resources. Consider also whether the trade system should incorporate environmental law or values, and whether environmental norms are consistent with international trade rules. Finally, consider whether trade bodies like the WTO are appropriate institutions for mediating the tensions between trade and environment values.

A. *The Problem*

Sea turtles are air-breathing reptiles that inhabit tropical and subtropical ocean waters throughout the world. Having traveled the seas for over 100 million years, sea turtles have outlived virtually all the prehistoric animals, including dinosaurs, with which they once shared the planet. However, sea turtle populations have declined precipitously in recent decades. For example, by 1990, the number of Kemp's ridley turtles at their only important nesting beach, on the Mexican coast of the Gulf of Mexico, had dropped to 1 percent of their population in 1947. At present, all species of sea turtle are listed as "species threatened with extinction which are or may be affected by trade" under the Convention on International Trade in Endangered Species; all turtle species that spend at least some portion of their lives in U.S. coastal waters are listed as endangered or threatened under the U.S. Endangered Species Act (ESA).

While sea turtle mortality is caused by a number of factors, including destruction and alteration of nesting and foraging habitats, predators, and diseases, authoritative studies have found that "the most important human-associated source of mortality is incidental capture in shrimp trawls, which accounts for more deaths than all other human activities combined." By some estimates, during the 1980s, commercial shrimp trawling was causing the deaths of approximately 124,000 turtles per year. As part of a program aimed at reducing turtle mortality, the U.S. National Marine Fisheries Service (NMFS) developed Turtle Excluder Devices (TEDs). TEDs are mechanical devices that permit turtles to escape from shrimp-trawling nets. Properly designed and installed, TEDs can reduce turtle mortality by approximately 97 percent.

In 1983, NMFS began to encourage U.S. shrimp vessels to use TEDs voluntarily. However, these efforts met with limited success as few shrimpers used TEDs on a regular basis. In 1987, the United States issued regulations, pursuant to the ESA, requiring

shrimp trawlers operating in ocean waters off the southeastern United States to use TEDs.

The shrimp fishery has the highest product value of any fishery in the United States. But many shrimpers complained that TEDs were expensive and time-consuming to install and clean, had to be replaced frequently, and that use of TEDs placed them at a competitive disadvantage vis-à-vis their foreign competitors. Environmental advocates noted that since U.S. shrimpers produce only 8 percent of the world's shrimp catch, and since turtles migrate great distances, unilateral efforts by U.S. shrimpers would be of limited effectiveness unless similar levels of protection were afforded throughout the turtles' migratory range.

In response to these concerns, in 1989, Congress enacted Section 609 of Public Law 101-162, which requires the federal government to initiate negotiations for agreements with nations engaged in fishing operations that might adversely affect sea turtles. Section 609 also provides that "the importation of shrimp or products from shrimp which have been harvested with commercial fishing technology which may affect adversely [sea turtles] shall be prohibited not later than May 1, 1991" unless the President certifies to Congress by May 1, 1991, and annually thereafter, that:

(A) the government of the harvesting nation has . . . [adopted] a regulatory program governing the incidental taking of such sea turtles . . . that is comparable to that of the United States; and

(B) the average rate of that incidental taking by the vessels of the harvesting nation is comparable to the average rate of incidental taking of sea turtles by United States vessels . . . ; or

(C) the particular fishing environment of the harvesting nation does not pose a threat of the incidental taking of such sea turtles. . . .

The U.S. State Department issued guidelines in 1991, amended in 1993, for assessing the comparability of foreign regulatory programs with the U.S. program. To be found comparable, a foreign nation's program had to include, inter alia, a commitment to require all shrimp trawl vessels to use TEDs at all times. Foreign states were given three years to complete the phase-in of a comparable program. The guidelines also provided that Section 609 would be applied only to the following states: Mexico, Belize, Guatemala, Honduras, Nicaragua, Costa Rica, Panama, Colombia, Venezuela, Trinidad and Tobago, Guyana, Suriname, French Guyana, and Brazil. Thus, under both the 1991 and 1993 Guidelines, national certification was the only way a harvesting state could export shrimp to the United States. The import of shrimp from uncertified states was prohibited, even if those particular shrimp had been caught by a shrimper that used TEDs. In addition, at this time, the United States began efforts to negotiate a treaty to protect sea turtles with the states of the Caribbean and Western Atlantic region.*

In 1995, a coalition of environmental NGOs filed suit in the U.S. Court of International Trade, a specialized court with jurisdiction over disputes arising under U.S. trade statutes, challenging the Administration's application of the statute only to shrimp harvested in the wider Caribbean/western Atlantic region. The court found that the Administration decided to limit the geographic application of Section 609 because a worldwide ban "could affect shrimp imports from more than 80 countries totaling as much as \$1.8 billion — more than 75 percent (by value) of all shrimp consumed in this country. The impact of the resulting embargoes would be unprecedented both internationally and

*The negotiations concluded in 1996 with the signing of the Inter-American Convention for the Protection and Conservation of Sea Turtles. The Convention entered into force in 2001 with Brazil, Costa Rica, Ecuador, Honduras, Mexico, the Netherlands, Peru, Venezuela, and the United States as parties.

domestically . . . [and] create major foreign policy problems with many countries." *Earth Island Institute v. Christopher*, 913 F. Supp. 559 (Ct. Intl. Trade 1995). The court held that there was no statutory basis for limiting the geographic application of Section 609 and directed the State Department "to prohibit not later than May 1, 1996 the importation of shrimp or products of shrimp wherever harvested in the wild with commercial fishing technology which may affect adversely [sea turtles]."

In response, in April 1996, the State Department issued revised guidelines (1996 Guidelines) which restricted imports of shrimp harvested from all waters inhabited by sea turtles, not just those of the wider Caribbean region. However, in contrast to the 1991 and 1993 Guidelines, the 1996 Guidelines permitted imports of shrimp from waters of uncertified states if the exporter included a declaration that the shrimp were "harvested under conditions that did not adversely affect [protected species of] sea turtles." Thus, under this shipment-by-shipment approach, a state did not need to be certified to export to the United States. Instead, a nation could satisfy Section 609 simply by employing TEDs on those vessels harvesting shrimp bound for the U.S. market.

Earth Island challenged the 1996 Guidelines. In October 1996, the court determined that Section 609 applied to all "shrimp or shrimp products harvested in the wild by citizens or vessels of nations which have not been certified." The court concluded that, by permitting imports of shrimp from noncertified countries that were harvested with technology that did not adversely affect sea turtles, the 1996 Guidelines were inconsistent with Section 609. Accordingly, the court prohibited the import of shrimp from noncertified harvesting nations. *Earth Island Institute v. Christopher*, 942 F. Supp. 597 (Ct. Intl. Trade 1996). This decision was later vacated on procedural grounds.

As a result of the various regulations and court rulings, during the mid-1990s the United States banned shrimp imports from a number of states. The ban had a significant economic effect; for example, shrimp exports from Malaysia fell from \$9.1 million in 1995 to \$4.86 million in 1996 and \$1.47 million in 1997. In 1997, India, Malaysia, Pakistan, and Thailand requested creation of WTO dispute settlement panels to determine whether the shrimp embargo violated the United States's WTO obligations.

B. The Tuna-Dolphin Dispute

The *Shrimp-Turtle* dispute was not the first time that a trade panel was asked to consider the legality of environmental measures that restrict trade under international trade law. A 1991 dispute involved a fact pattern strikingly similar to the *Shrimp-Turtle* dispute. That dispute, *United States — Restrictions on Imports of Tuna*, DS21/R-39S/155 (1991) (*Tuna-Dolphin I*) involved a challenge to certain provisions of the United States's Marine Mammal Protection Act (MMPA).^{*} These provisions were designed to protect dolphins that were incidentally caught by the commercial tuna fleet. Under that law, the U.S. fleet had to fish in a "dolphin safe" manner in order to sell their tuna on the U.S. market. Several years later, Congress amended the MMPA to require that, to import into the United States, foreign states had to adopt a regulatory program "comparable" to that of the United States and their fleets had to achieve an incidental dolphin kill rate "comparable" to that of the U.S. fleet. When the Administration proved reluctant to impose tuna

^{*}Much of the account that follows is drawn from Richard W. Parker, *The Use and Abuse of Trade Leverage to Protect the Global Commons: What We Can Learn from the Tuna-Dolphin Conflict*, 12 Geo. Intl. Env'tl. L. Rev. 1 (1999); James R. Joseph, *The Tuna-Dolphin Controversy in the Eastern Pacific Ocean: Biological, Economic and Political Impacts*, 25 Ocean Dev. & Intl. L. 1 (1994); Jeffrey L. Dunoff, *Reconciling International Trade with Preservation of the Global Commons: Can We Prosper and Protect?*, 49 Wash. & Lee L. Rev. 1407 (1992).

embargoes on foreign fleets, Earth Island Institute filed a federal court action that led to an order requiring the federal government to enforce the MMPA. Thereafter, the United States enforced a tuna embargo against a number of states, including Mexico. Mexico responded by initiating dispute settlement proceedings at the GATT.

As a matter of GATT law, the dispute involved the meaning of, and relationships among, GATT articles XI, III, and XX. Article XI provides that, subject to limited exceptions, "[n]o prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas . . . or other measures, shall be instituted or maintained" on imports from other GATT members. Article III provides that products imported from GATT parties shall "be accorded treatment no less favourable than that accorded to like products of national origin." Article XX provides, in relevant part, that:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail . . . , nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures. . . .

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

(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption; . . .

Mexico argued that the embargo violated Article XI. The United States responded that as the MMPA applies to both domestic and imported tuna, the challenged measures were "internal regulations" and hence governed by and consistent with Article III, rather than quotas governed by Article XI. The United States argued, in the alternative, that even if the embargo violated one of these articles, it fell within the Article XX exception. In September 1991, a GATT panel issued the following report:

United States — Restrictions on Imports of Tuna

DS21/R-39S/155 (1991)

5.9 . . . While restrictions on importation are prohibited by Article XI:1, contracting parties are permitted by Article III:4 and the Note Ad Article III [an interpretative note attached to the treaty] to impose an internal regulation on products imported from other contracting parties provided that it . . . accords to imported products treatment no less favourable than that accorded to like products of national origin. . . .

5.11 The text of Article III:1 refers to the application to imported or domestic *products* of "laws, regulations and requirements affecting the internal sale . . . of *products*" . . . ; it sets forth the principle that such regulations on *products* not be applied so as to afford protection to domestic production. Article III:4 refers solely to laws, regulations and requirements affecting the internal sale, etc. of *products*. This suggests that Article III covers only measures affecting products as such. . . .

5.14 . . . The Panel noted that the MMPA regulates the domestic harvesting of yellowfin tuna to reduce the incidental taking of dolphin, but that these regulations could not be regarded as being applied to tuna products as such because they would not directly regulate the sale of tuna and could not possibly affect tuna as a product. . . .

5.15 . . . Article III:4 calls for a comparison of the treatment of imported tuna *as a product* with that of domestic tuna as a product. Regulations governing the taking of dolphins incidental to the taking of tuna could not possibly affect tuna *as a product*. Article III:4 therefore obliges the United States to accord treatment to Mexican tuna no less

favourable than that accorded to United States tuna, whether or not the incidental taking of dolphins by Mexican vessels corresponds to that of United States vessels. . . .

[After rejecting the argument that the U.S. measure fell within the scope of Article III, the panel held that the import ban violated Article XI. The panel then considered whether the embargo fell within the scope of GATT Article XX.]

5.24 The Panel noted that the United States considered [its embargoes] . . . to be justified by Article XX(b) because they served solely the purpose of protecting dolphin life and health and were "necessary" . . . because, in respect of the protection of dolphin life and health outside its jurisdiction, there was no alternative measure reasonably available to the United States to achieve this objective. Mexico considered that Article XX(b) was not applicable to a measure imposed to protect the life or health of animals outside the jurisdiction of the contracting party taking it. . . .

5.25 The Panel noted that the basic question . . . whether Article XX(b) covers measures necessary to protect human, animal or plant life or health outside the jurisdiction of the contracting party taking the measure, is not clearly answered by the text of that provision. The Panel therefore decided to analyze this issue in the light of the drafting history of Article XX(b), the purpose of this provision, and the consequences that the interpretations proposed by the parties would have for the operation of the General Agreement as a whole.

5.26 [In an earlier draft of Article XX,] exception (b) read: "For the purpose of protecting human, animal or plant life or health, if corresponding domestic safeguards under similar conditions exist in the importing country." This [final clause] reflected concerns regarding the abuse of sanitary regulations by importing countries. Later, [a drafting committee] agreed to drop this proviso as unnecessary. Thus, the record indicates that the concerns of the drafters of Article XX(b) focused on the use of sanitary measures to safeguard life or health of humans, animals or plants within the jurisdiction of the importing country.

5.27 . . . The Panel recalled the finding of a previous panel that [Article XX(b)] was intended to allow contracting parties to impose trade restrictive measures inconsistent with the General Agreement to pursue overriding public policy goals to the extent that such inconsistencies were unavoidable. The Panel considered that if the broad interpretation of Article XX(b) suggested by the United States were accepted, each contracting party could unilaterally determine the life or health protection policies from which other contracting parties could not deviate without jeopardizing their rights under the General Agreement. The General Agreement would then no longer constitute a multilateral framework for trade among all contracting parties but would provide legal security only in respect of trade between a limited number of contracting parties with identical internal regulations.

5.28 The Panel considered that the United States' measures, even if Article XX(b) were interpreted to permit extrajurisdictional protection of life and health, would not meet the requirement of necessity set out in that provision. The United States had not . . . exhausted all options reasonably available to it to pursue its dolphin protection objectives through measures consistent with the General Agreement, in particular through the negotiation of international cooperative arrangements. . . . Moreover . . . [t]he United States linked the maximum incidental dolphin taking rate which Mexico had to meet . . . to the taking rate actually recorded for United States fishermen during the same period. Consequently, the Mexican authorities could not know whether, at a given point of time, their policies conformed to the United States' dolphin protection standards. The Panel considered that a limitation on trade based on such unpredictable conditions could not be regarded as necessary to protect the health or life of dolphins. . . .

Notes and Questions

1. In its Article III analysis, the panel sharply distinguishes between (permissible) regulations based upon the "product as such" and (impermissible) regulations based upon the process through which a product is made. What values does this distinction further? Can you identify the economic logic, based upon a theory of comparative advantage, of this distinction? If the United States could ban tuna based on the way it is caught, could it ban products from countries where workers get paid unfair wages? On the other hand, why can the United States protect dolphins by, for example, banning the import of dead dolphins, but not do so by banning tuna caught in a way that produces dead dolphins?

2. Consider the three arguments the panel relies upon in concluding that Article XX does not reach trade measures designed to protect a resource outside a state's territory:

First, in paragraph 5.26, the panel relies on the drafters' elimination of a clause from an earlier draft of Article XX. Do you agree with the inference that the panel draws from the drafting history? Second, in paragraph 5.28, the panel argues that the U.S. measure was not "necessary" because the United States had not pursued an international agreement on dolphin protection. The panel ignored U.S. dolphin conservation efforts through the Inter-American Tropical Tuna Commission (IATTC) for many years prior to the MMPA embargoes, as well as Mexico's opposition to these efforts. Third, the panel argues that the U.S. measure is not "necessary" because it used a standard that was "unpredictable." Does the panel explain why unpredictable measures cannot be necessary measures? Does the panel suggest any alternative measures that were reasonably available to the United States?

3. The panel could have rejected the United States's article XX argument on the narrow ground that the embargo was not "necessary" as that term is used in article XX(b). Why did the panel reach the issue of whether a nation can restrict imports for the purpose of protecting environmental resources outside its own jurisdiction?

Under GATT dispute resolution procedures, panel reports could be adopted only by consensus. The United States objected to the broad language of the panel report. Mexico also did not seek adoption of the report. Many observers suggest that, given the ongoing NAFTA negotiations, Mexico sought to avoid a high-profile environmental dispute with the United States.

The panel report did not end the tuna-dolphin dispute. The United States neither lifted the embargo nor changed the MMPA. To the contrary, during 1991 and 1992, the United States banned the importation of tuna from a number of intermediary nations, including Costa Rica, Ecuador, France, Indonesia, Malaysia, Panama, Spain, Thailand, the United Kingdom, and Venezuela. In response, the EC and the Netherlands filed a challenge to the MMPA's "intermediary nation" provisions, which banned imports from "intermediary nations" unless those nations act to ban tuna imports from nations subject to direct embargoes. In a lengthy report (*Tuna Dolphin II*), the panel found that the embargoes violated Article XI, used the product/process distinction to reject the United States's Article III argument, and found that the embargoes did not fall within the scope of Article XX. Once again, the United States blocked adoption of the panel report and maintained its tuna embargoes. The report, however, increased the international pressure on the United States to modify its tuna policy, as well as the environmental community's distrust of the GATT.

In April 1992, Colombia, Costa Rica, Ecuador, Mexico, Nicaragua, Panama, Spain, Vanuatu, Venezuela, and the United States entered into a nonbinding agreement (the La Jolla agreement), which included a schedule to reduce total dolphin takes through the imposition of annual limits to be allocated among fishing vessels that meet certain criteria, including the use of certain dolphin-safe fishing techniques. Thereafter, two bills to amend the MMPA came before the U.S. Congress. One would have implemented the La Jolla agreement, and imposed embargoes on nations failing to meet their commitments under the agreement. This bill was rejected in favor of the International Dolphin Conservation Act of 1992, which lifted the U.S. embargo for nations that agreed to a five-year moratorium on fishing techniques that threatened dolphins. While Mexico and Venezuela initially expressed interest in a moratorium, no nation concluded a moratorium agreement with the United States. Thus, notwithstanding the two panel reports and the La Jolla agreement, the tuna embargoes remained in place. Nevertheless, foreign fleets followed the La Jolla agreement for several years, and dolphin mortality dropped from 15,539 in 1992 to 2,547 in 1996.

However, foreign fleets complained that they still lacked access to the U.S. market, and six of the states that had signed the La Jolla agreement threatened to withdraw from the agreement. The IATTC and the U.S. State Department argued that the embargoes had outlived their usefulness. Given the two adverse GATT panel reports and significant pressure from the embargoed nations, the status quo was unsustainable. In 1995, representatives from 12 governments and five major environmental NGOs met in Panama. The resulting Panama Declaration — signed by the 12 states — formalized various components of the La Jolla agreement into a binding international agreement. The Panama Declaration created a permanent mortality limit and provided for the lifting of the U.S. embargoes on tuna caught in compliance with the La Jolla agreement. In 1997, Congress passed legislation implementing most of the Panama Declaration.

Notably, the 1997 legislation contained provisions that would weaken U.S. law with respect to labeling cans of tuna “dolphin-safe,” contingent upon a finding by the Secretary of Commerce that catching dolphins with purse-seine nets was not having a significant adverse impact on dolphin stocks. In December 2002, the Secretary made such a finding. However, in *Earth Island v. Hogarth*, 484 F.3d 1123 (9th Cir. 2007), the court determined that the Secretary’s finding was inconsistent with the best available scientific evidence. As a result, Mexican tuna caught with purse-seine net cannot use the “dolphin-safe” label. In March 2009, Mexico requested creation of a WTO panel to hear its claim that the U.S. labeling law violated WTO non-discrimination norms. Several days later, the United States demanded that Mexico withdraw its WTO request and pursue its claim under North American Free Trade Agreement (NAFTA) dispute resolution proceedings, citing a forum selection clause in NAFTA. In April 2009, the WTO established a panel to hear the dispute. In November 2009, the United States formally requested NAFTA consultations with Mexico. As of January 2010, WTO and NAFTA proceedings were pending.

Notes and Questions

1. One commentator has observed that the Tuna-Dolphin conflict led to “the quiet emergence of one of the most innovative and effective environmental regimes in the world — a regime which has reduced dolphin mortality by over 99% while eliciting a very high level of compliance from all fishers and flag states in the fishery.” Richard W. Parker, *The Use and Abuse of Trade Leverage to Protect the Global Commons: What Can We Learn From*

the *Tuna-Dolphin Conflict*, 12 Geo. Intl. Env'tl. L. Rev. 1, 6 (1999). Do the events following the *Tuna-Dolphin I* panel tend to vindicate or undermine the panel's reasoning? Was an agreement among the relevant countries rendered more or less likely by panel rulings that the U.S. embargoes were inconsistent with international trade law? What lessons does the *Tuna-Dolphin* dispute hold regarding the use of trade measures to achieve environmental ends?

2. Note that states used both nonbinding and binding agreements to attempt to resolve the tuna-dolphin conflict. Recalling the discussion of soft law in Chapter 2, why would states attempt to resolve this dispute through a nonbinding instrument? Why did they then employ a binding agreement?

C. The WTO Dispute Settlement Reports

In May 1998, the WTO panel issued its report in the *Shrimp-Turtle* dispute. It found that the U.S. embargo was inconsistent with Article XI. In rejecting the U.S. argument that the ban fell within the scope of Article XX, the panel focused on Article XX's chapeau, which provides that no trade measure shall be applied "in a manner that would constitute a means or arbitrary or unjustifiable discrimination where the same conditions prevail. . . ." The panel's key findings and supporting rationale are excerpted below.

7.40 . . . As the Appellate Body [stated], Article XX "needs to be read in its context and in such a manner as to give effect to the purposes and objects of the General Agreement" and "the purpose and object of the introductory clauses of Article XX is generally the prevention of 'abuse of the exceptions of . . . [Article XX]'." . . .

7.42 We consequently turn to the consideration of the object and purpose of the WTO Agreement. . . . While the WTO Preamble confirms that environmental considerations are important for the interpretation of the WTO Agreement, the central focus of that agreement remains the promotion of economic development through trade; and the provisions of GATT are essentially turned toward liberalization of access to markets on a nondiscriminatory basis.

7.44 Therefore, we are of the opinion that the chapeau [of] Article XX, interpreted within its context and in the light of the object and purpose of GATT and of the WTO Agreement, only allows Members to derogate from GATT provisions so long as, in doing so, they do not undermine the WTO multilateral trading system, thus also abusing the exceptions contained in Article XX. Such undermining and abuse would occur when a Member jeopardizes the operation of the WTO Agreement in such a way that guaranteed market access and nondiscriminatory treatment within a multilateral framework would no longer be possible. . . . We consequently find that when considering a measure under Article XX, we must determine not only whether the measure on its own undermines the WTO multilateral trading system, but also whether such type of measure, if it were to be adopted by other Members, would threaten the security and predictability of the multilateral trading system.

7.45 In our view, if [the chapeau of Article XX were to be interpreted to] allow a Member to adopt measures conditioning access to its market for a given product upon the adoption by the exporting Members of certain policies . . . the WTO Agreement could no longer serve as a multilateral framework for trade among Members as security and predictability of trade relations under those agreements would be threatened. This follows because, if one WTO Member were allowed to adopt such measures, then other Members would also have the right to adopt similar measures on the same subject but with differing, or even conflicting, requirements. . . . Market access for goods could become subject to an increasing number of conflicting policy requirements for the same product and this would rapidly lead to the end of the WTO multilateral trading system. . . .

7.49 Accordingly, it appears to us that, in light of the context of the term “unjustifiable” and the object and purpose of the WTO Agreement, the US measure at issue constitutes unjustifiable discrimination [and thus violates Article XX]. . . .

United States—Import Prohibition of Certain Shrimp and Shrimp Products, WT/DS58/R (1998).

The United States appealed. In a landmark report, the Appellate Body rejected much of the panel’s reasoning and applied a two-part test in determining whether the U.S. measure fell within the scope of Article XX.

United States — Import Prohibition of Certain Shrimp and Shrimp Products

WT/DS58/AB/R (1998)

118. In [a previous dispute], we enunciated the appropriate method for applying Article XX. . . .

In order that [Article XX apply], the measure at issue must not only come under one or another of the particular exceptions — paragraphs (a) to (j) — listed under Article XX; it must also satisfy the requirements imposed by the opening clauses of Article XX. *The analysis is, in other words, two-tiered: first, provisional justification by reason of characterization of the measure under XX(g); second, further appraisal of the same measure under the introductory clauses of Article XX.*

127. We begin with the threshold question of whether Section 609 is a measure concerned with the conservation of “exhaustible natural resources” within the meaning of Article XX(g). . . . India, Pakistan and Thailand contended that . . . the term refers to “finite resources such as minerals, rather than biological or renewable resources.” In their view, such finite resources were exhaustible “because there was a limited supply which could and would be depleted unit for unit as the resources were consumed.” Moreover, they argued, if “all” natural resources were considered to be exhaustible, the term “exhaustible” would become superfluous. . . .

129. The words of Article XX(g), “exhaustible natural resources,” were actually crafted more than 50 years ago. They must be read by a treaty interpreter in the light of contemporary concerns of the community of nations about the protection and conservation of the environment. . . .

130. From the perspective embodied in the preamble of the *WTO Agreement* [which explicitly acknowledges “the objective of sustainable development”], we note that the generic term “natural resources” in Article XX(g) is not “static” in its content or reference but is rather “by definition, evolutionary.” It is, therefore, pertinent to note that modern international conventions and declarations make frequent references to natural resources as embracing both living and non-living resources. . . . [The Appellate Body then cited several multilateral environmental agreements that referred to living natural resources.]

131. . . . We hold that, in line with the principle of effectiveness in treaty interpretation, measures to conserve exhaustible natural resources, whether *living* or *non-living*, may fall within Article XX(g). . . .

133. Finally, we observe that sea turtles are highly migratory animals, passing in and out of waters subject to the rights of jurisdiction of various coastal states and the high

seas. . . . We do not pass upon the question of whether there is an implied jurisdictional limitation in Article XX(g), and if so, the nature or extent of that limitation. We note only that in the specific circumstances of the case before us, there is a sufficient nexus between the migratory and endangered marine populations involved and the United States for purposes of Article XX(g). . . .

156. Turning then to the chapeau of Article XX, we consider that it embodies the recognition on the part of WTO Members of the need to maintain a balance of rights and obligations between the right of a Member to invoke one or another of the exceptions of Article XX . . . on the one hand, and the substantive rights of the other Members under the GATT 1994, on the other hand. . . .

159. The task of interpreting and applying the chapeau is, hence, essentially the delicate one of locating and marking out a line of equilibrium between the right of a Member to invoke an exception under Article XX and the rights of the other Members under varying substantive provisions (e.g., Article XI) of the GATT 1994, so that neither of the competing rights will cancel out the other and thereby distort and nullify or impair the balance of rights and obligations constructed by the Members themselves in that Agreement. The location of the line of equilibrium, as expressed in the chapeau, is not fixed and unchanging; the line moves as the kind and the shape of the measures at stake vary and as the facts making up specific cases differ.

165. . . . [Under Section 609,] shrimp caught using methods identical to those employed in the United States have been excluded from the United States market solely because they have been caught in waters of countries that have not been certified by the United States. The resulting situation is difficult to reconcile with the declared policy objective of protecting and conserving sea turtles. This suggests to us that this measure . . . is more concerned with effectively influencing WTO members to adopt essentially the same comprehensive regulatory regime as that applied by the United States to its domestic shrimp trawlers, even though many of those members may be differently situated. We believe that discrimination results not only when countries in which the same conditions prevail are differently treated, but also when the application of the measure at issue does not allow for any inquiry into the appropriateness of the regulatory program for the conditions prevailing in those exporting countries.

166. Another aspect of the application of Section 609 that bears heavily in any appraisal of justifiable or unjustifiable discrimination is the failure of the United States to engage the appellees, as well as other Members exporting shrimp to the United States, in serious, across-the-board negotiations with the objective of concluding bilateral or multilateral agreements for the protection and conservation of sea turtles, before enforcing the import prohibition against the shrimp exports of those other Members. . . .

172. Clearly, the United States negotiated seriously with some, but not with other Members (including the appellees), that export shrimp to the United States. The effect is plainly discriminatory and, in our view, unjustifiable. . . .

173. The application of Section 609, through the implementing guidelines together with administrative practice, also resulted in other differential treatment among various countries desiring certification. [Under the guidelines implementing Section 609, the 14 states in the wider Caribbean/western Atlantic region had a "phase-in" period of three years to adopt TEDs while all other states had only four months to implement the requirement of compulsory use of TEDs.] . . .

176. When the foregoing differences in the means of application of Section 609 to various shrimp exporting countries are considered in their cumulative effect, we find, and

so hold, that those differences in treatment constitute “unjustifiable discrimination” between exporting countries desiring certification in order to gain access to the United States shrimp market within the meaning of the chapeau of Article XX. . . .

The Appellate Body report did not end the Shrimp-Turtle dispute. In July 1999, the State Department issued Revised Guidelines for the implementation of Section 609. These guidelines set forth various criteria for certification. The guidelines stated that Section 609’s import ban does not apply to shrimp harvested under any circumstance “that the Department of State may determine . . . does not pose a threat of the incidental taking of sea turtles.” Thus, the 1999 Guidelines continued to permit importation of TED-caught shrimp from uncertified nations under a shipment-by-shipment approach. The guidelines also attempted to provide greater flexibility to harvesting states by permitting certification “[i]f the government of a harvesting nation demonstrates that it has implemented . . . a comparably effective regulatory program to protect sea turtles in the course of shrimp trawl fishing without the use of TEDs. . . .” In addition, the United States initiated efforts to negotiate a sea turtle conservation treaty in the Indian Ocean region and offered to provide technical assistance in the installation and use of TEDs to other governments. However, the United States did not amend Section 609, and did not lift the embargo against shrimp from Malaysia.

In October 2000, Malaysia requested a WTO panel to rule on whether the United States’s failure to lift the import prohibition on shrimp constituted noncompliance with the Appellate Body report. In June 2001, the panel held, *inter alia*, that the United States could keep its embargo so long as it demonstrated “ongoing serious good faith efforts” to reach a multilateral agreement on the protection of sea turtles in the Indian Ocean region. However, the panel emphasized that the ability to impose unilateral measures to protect sea turtles “is more to be seen, for purposes of Article XX, as the possibility to adopt a provisional measure allowed for emergency reasons than as a definitive ‘right’ to take a permanent measure.” Malaysia appealed, and in October 2001, the Appellate Body issued the *Shrimp-Turtle II* report.

122. We concluded in [*Shrimp-Turtle I*] that, to avoid “arbitrary or unjustifiable discrimination”, the United States had to provide all exporting countries “similar opportunities to negotiate” an international agreement. . . . The negotiations need not be identical. . . . Yet the negotiations must be comparable in the sense that comparable efforts are made, comparable resources are invested, and comparable energies are devoted to securing an international agreement. So long as such comparable efforts are made, it is more likely that “arbitrary or unjustifiable discrimination” will be avoided between countries where an importing Member concludes an agreement with one group of countries, but fails to do so with another group of countries.

123. . . . Requiring that a multilateral agreement be concluded by the United States in order to avoid “arbitrary or unjustifiable discrimination” in applying its measure would mean that any country party to the negotiations with the United States . . . would have, in effect, a veto over whether the United States could fulfill its WTO obligations. Such a requirement would not be reasonable. For a variety of reasons, it may be possible to conclude an agreement with one group of countries but not another. . . . In our view, the United States cannot be held to have engaged in “arbitrary or unjustifiable discrimination” under Article XX solely because one international negotiation resulted in an agreement while another did not.

134. . . . Therefore, we uphold the Panel’s finding that, in view of the serious, good faith efforts made by the United States to negotiate an international agreement, “Section 609 is now applied in a manner that no longer constitutes a means of unjustifiable or arbitrary discrimination, as identified by the Appellate Body in its Report.”

135. We now turn to Malaysia's arguments relating to the flexibility of the Revised Guidelines. Malaysia argued before the Panel that the measure at issue results in "arbitrary or unjustifiable discrimination" because it conditions the importation of shrimp into the United States on compliance by the exporting Members with policies and standards "unilaterally" prescribed by the United States. . . .

140. In [*Shrimp-Turtle I*], we concluded that the measure at issue there did not meet the requirements of the chapeau of Article XX relating to "arbitrary or unjustifiable discrimination" because, through the application of the measure, the exporting members were faced with "a single, rigid and unbending requirement" to adopt essentially the same policies and enforcement practices as those applied to, and enforced on, domestic shrimp trawlers in the United States. In contrast, in this dispute, the Panel found that this new measure is more flexible than the original measure and has been applied more flexibly than was the original measure. . . .

144. In our view, there is an important difference between conditioning market access on the adoption of essentially the same programme, and conditioning market access on the adoption of a programme comparable in effectiveness. Authorizing an importing Member to condition market access on exporting Members putting in place regulatory programmes comparable in effectiveness to that of the importing Member gives sufficient latitude to the exporting Member . . . to adopt a regulatory programme that is suitable to the specific conditions prevailing in its territory. . . . [T]he Panel correctly reasoned and concluded that conditioning market access on the adoption of a programme comparable in effectiveness, allows for sufficient flexibility in the application of the measure so as to avoid "arbitrary or unjustifiable discrimination". . . .

152. For all of these reasons, we uphold the finding of the Panel [that the United States is in compliance with *Shrimp-Turtle I*] as long as the conditions stated in the findings of this Report, in particular the ongoing serious, good faith efforts to reach a multilateral agreement, remain satisfied.

United States — Import Prohibition on Certain Shrimp and Shrimp Products, WT/DS58/AB/RW (2001).

Notes and Questions

1. The *Tuna-Dolphin I* report and the *Shrimp-Turtle* panel report suggest that unilateral measures that condition market access on the policies of exporting states are, in general, not justifiable under Article XX. In *Shrimp-Turtle I*, the Appellate Body stated:

In the present case, the Panel found that the [U.S.] measure [was] excluded . . . because Section 609 conditions access to the domestic shrimp market of the United States on the adoption by exporting countries of certain conservation policies prescribed by the United States. It appears to us, however, that conditioning access to a member's domestic market on whether exporting Members comply with, or adopt, a policy . . . unilaterally prescribed by the importing Member may . . . be a common aspect of measures falling within the scope of one or another of the exceptions . . . of Article XX. . . . It is not necessary to assume that requiring from exporting countries compliance with, or adoption of, certain policies . . . prescribed by the importing country renders a measure a priori incapable of justification under Article XX. Such an interpretation renders most, if not all, of the specific exceptions of Article XX inutile. . . .

Shrimp-Turtle II rejected Malaysia's argument that this statement was dicta and affirmed that "this statement expresses a principle that was central to our ruling in [*Shrimp-Turtle I*]." After *Shrimp-Turtle I* and *II*, under what conditions are unilateral measures restricting trade permissible under Article XX?

2. In *Shrimp-Turtle I*, the Appellate Body stated that its “task” was to find the shifting “line of equilibrium” between conflicting trade and environmental interests, and its rationale departed sharply from that employed by previous panels. Was the Appellate Body engaged in a law-making function similar to that exercised by common law courts? Does the fact that international negotiations have failed to make significant progress on trade-environment issues justify a more activist role for panels?

3. The *Shrimp-Turtle* panel interpreted Article XX “within its context and in the light of the object and purpose of GATT.” In *Shrimp-Turtle I*, the Appellate Body interpreted Article XX in an “evolutionary” manner “in the light of contemporary concerns . . . about the protection and conservation of the environment.” Recalling the Vienna Convention’s provisions on treaty interpretation discussed in Chapter 2, which interpretative methodology is more appropriate? Which interpretative methodology is more consistent with the DSU provision stating that “[r]ecommendations and rulings of [panels] cannot add to or diminish the rights and obligations provided in the covered agreements”? Recalling the ICJ’s treaty analysis in the *Gabcikovo* case discussed in Chapter 11, are there particular reasons to adopt an “evolutionary” approach when environmental concerns are at issue?

4. Does the Appellate Body’s determination in *Shrimp-Turtle II* that the United States could maintain its embargo make the negotiation of regional conservation agreements more or less likely? How does it change the strategic environment in which such negotiations take place? Consider in this regard Ronald Coase’s insight that, in a world where bargaining entails significant transaction costs, negotiated agreements will be affected by background legal rules on which the parties can rely in the absence of an agreement.

5. There is significant scholarly debate over whether panels should use non-trade international law. While several GATT panels rejected attempts by parties to rely on international environmental agreements, in *Shrimp-Turtle I*, the Appellate Body explicitly invoked several such agreements. What are the advantages and disadvantages of having panels incorporate non-trade law into WTO dispute resolution processes? Are panels competent, in either a legal or technical sense, to interpret non-WTO law?

6. WTO dispute processes continue to address trade-environment controversies. In *Brazil — Measures Affecting Imports of Retreaded Tyres*, decided in 2007, the Appellate Body discussed at length the meaning of “necessary” for purposes of Article XX. In addition, in November 2009, Canada requested dispute settlement consultations with the EC with respect to an EC ban on the import of seal products. More information on these and other WTO disputes can be found at www.wto.org.

III. RESOLVING INVESTMENT DISPUTES: ECONOMIC TURMOIL IN ARGENTINA

While states created the WTO and use its dispute settlement system, today multinational corporations — and their employees — are the major creators and drivers of the world economy. Approximately 82,000 multinationals, and their 810,000 foreign affiliates, do so by producing trillions of dollars’ worth of goods and services that cross international borders each year. Increasingly, these goods and services are made by local companies whose ownership or financing originates elsewhere. This section examines some of the international legal norms that apply to foreign direct investment (FDI), the process

whereby an investor based in one state transfers capital to another state to create or purchase an asset in that other state, giving the investor a stake in the income the asset produces. FDI typically involves a long-term relationship reflecting the investor's ongoing interest in a foreign entity.

Until the 2008 financial crisis, the amount of new global FDI had been dramatically increasing for well over two decades. From 1983 to 1990, for example, FDI grew at an annual rate of 26 percent, and by 2007, global FDI inflows totaled a record \$1,833 billion. Despite the global economic slowdown, foreign investment remains an enormously important driver of the global economy. Recent FDI differs from that of the past in several respects. First, there has been a shift from a focus on manufacturing and hydrocarbons in the 1960s and 1970s, to an increasing focus on services since the early 1990s. Domestic deregulation in various sectors — such as telecommunications, electricity, banking, insurance, and airlines — along with rapid technological change, trade liberalization, and privatization have all contributed to this shift. Second, most of the growth in international production over the past decade has come from cross-border mergers and acquisitions (M&As); the value of cross-border M&As rose from less than \$100 billion in 1987 to roughly \$1.6 trillion in 2007. Cross-border M&As often represent the fastest means of establishing a strong position in new markets and allow firms to realize synergies through the pooling of proprietary resources.

While much of the debate over FDI involves North-South issues, most global FDI flows among developed states. Hence, in 2008, the top ten outward investor states were, in order, the United States, France, Germany, Japan, United Kingdom, Switzerland, Canada, Spain, Belgium, and Hong Kong. The top ten recipient states in 2008, in order, were the United States, France, China, United Kingdom, Russia, Spain, Hong Kong, Belgium, Australia, and Brazil.

Nevertheless, it is difficult to overstate the dramatic increase in foreign capital flows to developing states. These flows increased tenfold from 1982 to 1993 and almost twentyfold by 1996, with a 40 percent increase in FDI inflows from 1994 to 1995 alone. By 2008, FDI inflows into developing states rose to a new record level of \$621 billion, more than double the figure in 2005. However, these flows have not been evenly distributed. Indeed, a relatively small number of developing states — including China, Brazil, Mexico, and Singapore — account for the majority of total flows to developing states. In contrast, FDI in the least developed countries constituted only 2 percent of total FDI flows.

FDI is politically controversial. On the one hand, it promises many benefits to the host state. It brings in needed capital and provides employment and, often, increased foreign exchange earnings. It also provides a number of resources that are only imperfectly tradable on markets, such as advanced technologies and management skills. But FDI can bring corruption and restrictive business practices, and international corporations can manipulate prices in interfirm transactions, depriving a host state of its fair share of tax revenues. And many believe that its economic benefits disproportionately flow to small groups of elites in the host state rather than to the population as a whole. Moreover, FDI can bring a perceived loss of national control or prestige through the sale to foreigners of important national assets. In addition to the political controversy over FDI, there has been significant controversy in the postwar era over the legal norms applicable to FDI, as seen in Chapter 2.

Foreign investment — and legal efforts to protect it — long predate these controversies. During the eighteenth century, much foreign investment occurred in the context of colonial expansion, and the imperial system protected much of the investment that

flowed to colonies. Significant international legal efforts in this area began in the nineteenth century as rapid industrialization, the spread of the corporate form of business, and creation of securities markets all combined to fuel a substantial increase in foreign investment. At the same time, the United States and other countries entered into a series of Friendship, Commerce, and Navigation (FCN) treaties. While the earliest FCN treaties focused upon trade and navigation, by the World War II era their primary purpose was the protection of foreign investment.

While the United States was negotiating FCNs into the 1960s, several European states were entering into bilateral investment protection agreements with developing states. The United States began to enter into bilateral investment treaties (BITs) with developing states in the 1980s. Both the European and the U.S. investment treaties reflected a belief that the treaties would provide a favorable and stable legal environment; guarantees in an international agreement were considered preferable to those provided under the host state's domestic laws, which were subject to change. The total number of BITs rose dramatically after 1980, and by the end of 2008, states from all parts of the world had entered into 2,676 BITs. In recent years, states have increasingly included investment provisions in regional agreements, such as NAFTA.

In this section, we explore the nature and scope of investor protections and investor-state dispute settlement mechanisms. As you review these materials, consider whether investment treaties clearly delineate the rights of investors and host states, and whether these provisions strike an appropriate balance among the interests of the investor, the host state, and other societal actors. Consider also the interplay of customary and treaty norms in investment arbitration, and whether and how states should address inconsistent arbitral awards. Finally, consider why states have not developed a multilateral investment regime akin to the trade regime, and whether they should.

A. The Problem

In late 1989, Argentina's government undertook a dramatic set of reforms to restart a stagnant economy. Among other measures, the government introduced a new currency, the peso, and a new foreign exchange regime. The so-called Convertibility Law provided that the peso was to be freely convertible with the U.S. dollar at a one-to-one rate, and that the external value of the peso would be pegged to the dollar by a currency board. This system was intended to prevent the government from issuing more currency than could be backed by its foreign currency reserves. This, in turn, would limit inflation and contribute to economic stability. A number of other measures opened the economy to foreign trade and investment. Most significantly, Argentina concluded a considerable number of BITs, including one with the United States.

For most of the next decade, the new policies produced impressive results. Inflation fell from a monthly rate of 27 percent in February 1991 to a monthly rate of 2.8 percent by May 1991, and Argentina experienced strong economic growth during the 1990s. The new policies also stimulated significant amounts of foreign investment; Argentina received more than \$100 billion in new capital inflows between 1992 and 1999.

As part of its reform strategy, the government decided to privatize a number of state-owned entities, including a natural gas transportation and distribution monopoly. A 1992 Gas Law set out a complex regulatory framework for the gas sector and created a government regulator, ENARGAS, to oversee this sector. This body was empowered to

set transportation and distribution tariffs at "fair and reasonable" rates. Under the Gas Law, tariffs were to be adjusted semi-annually in accordance with the U.S. Producer Price Index (PPI). To facilitate the privatization process, a government decree set forth a model license that embodied the basic rules applicable to the gas sector. The license included a schedule of tariffs and required the government to compensate licensees for any losses resulting from changes to the guaranteed tariff system. As a result, the former state monopoly was converted into two transportation and eight distribution companies, each responsible for a geographic region of the country. A significant number of foreign investors purchased shares in these companies and made substantial investments in Argentina's gas sector.

However, starting in 1998, Argentina's economy began to unravel. The economy shrank by more than 3 percent in the second half of 1998, and by more than 3.5 percent in 1999, sparking significant increases in unemployment and poverty. Although many economists argued that the peso was overvalued, the Convertibility Law limited the government's ability to adjust the value of its currency. The downturn intensified in 2000 and 2001, until the economy collapsed in late 2001. The value of stock and other assets in Argentina plummeted, and massive strikes shook the country. The economic downturn had a devastating economic and social impact. By the end of the year, many Argentines did not have the resources to buy subsistence amounts of food. The economic crisis sparked political instability; at one point five presidents took office over a span of only ten days. In response to a run on the banks in December 2001, the government prohibited international currency transfers and restricted bank withdrawals.

Against this background, Argentina sought to renegotiate provisions for adjusting gas tariffs. In January 2000, the government and the gas companies agreed to a six-month postponement in tariff adjustments; the deferral was to be recouped during 2000-2001, and any losses would be indemnified. However, as the economy continued to deteriorate, in July 2000, the parties agreed to a further two-year postponement in tariff adjustments. This new arrangement, embodied in a government decree, provided that PPI adjustments would be reintroduced in 2002, income lost from the deferral would be gradually recovered, and the PPI adjustment was a "legitimately acquired right" of the companies.

On January 6, 2002, the government enacted the so-called Emergency Law. It declared a public emergency until December 6, 2003, and abolished peso-dollar convertibility, so that the one-to-one peg of the peso to the dollar no longer existed. In addition, the law terminated the right of privatized utilities, including the gas companies, to payments calculated in dollars and the right to adjust those tariffs on the basis of the PPI. The law forbade public utility companies from suspending or modifying compliance with their obligations under their concessions and licenses. The Emergency Law provided for a process of renegotiation of licenses to operate the gas transportation and distribution companies. Several attempts by the gas companies and the government to implement emergency increases in gas and electricity tariffs were blocked by the Argentine courts.

Foreign investors claimed that the government's measures produced devastating consequences for their investments. Some claimed, for example, that the sudden devaluation of the peso reduced their revenue by two-thirds. Firms in the gas sector asserted that revenues from tariffs fell by nearly 75 percent and that the value of their stock shares fell by more than 90 percent. In response, Argentina argued that any losses resulted from the firms' business decisions.

B. Bilateral Investment Treaties

The U.S.-Argentina BIT, like other investment agreements, is designed to establish a secure environment for investors by providing detailed rules for treatment of foreign investment and establishing effective means of dispute resolution. Although the terms of BITs vary, the investor protection rules are generally organized around five key principles:

(1) *National Treatment and Most-Favored-Nation Treatment:* Many investment treaties require parties to accord investors from other parties "treatment no less favorable than that it accords, in like circumstances, to its own investors," as well as "treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party." These provisions are designed to ensure that parties do not favor domestic over foreign investors and do not discriminate among foreign investors.

(2) *Fair and Equitable Treatment:* Article II of the U.S.-Argentina BIT provides that "investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law." This language is meant to incorporate customary international law norms regarding the minimum standard of treatment of foreign investment.

(3) *Prohibition on So-Called Performance Requirements:* Like other investment agreements, the U.S.-Argentina treaty provides that neither party can require that investors make certain concessions, such as promises to employ a certain number of local personnel, export a certain percentage of output, or achieve a certain percentage of domestic content in its goods. These provisions eliminate the economic distortions that performance requirements create and protect investor autonomy.

(4) *Free Transfers:* The U.S.-Argentina BIT requires that parties permit all financial transfers abroad related to an investment, including profits, dividends, interest, capital gains, and fees, to be made "freely and without delay" and in a "freely usable currency at the prevailing market rate of exchange." These clauses ensure that investors will be able to expatriate their profits.

(5) *International Law Standards on Expropriation and Compensation:* Virtually all BITs address the standard of compensation to be paid in the event of an expropriation. Article IV of the U.S.-Argentina BIT provides:

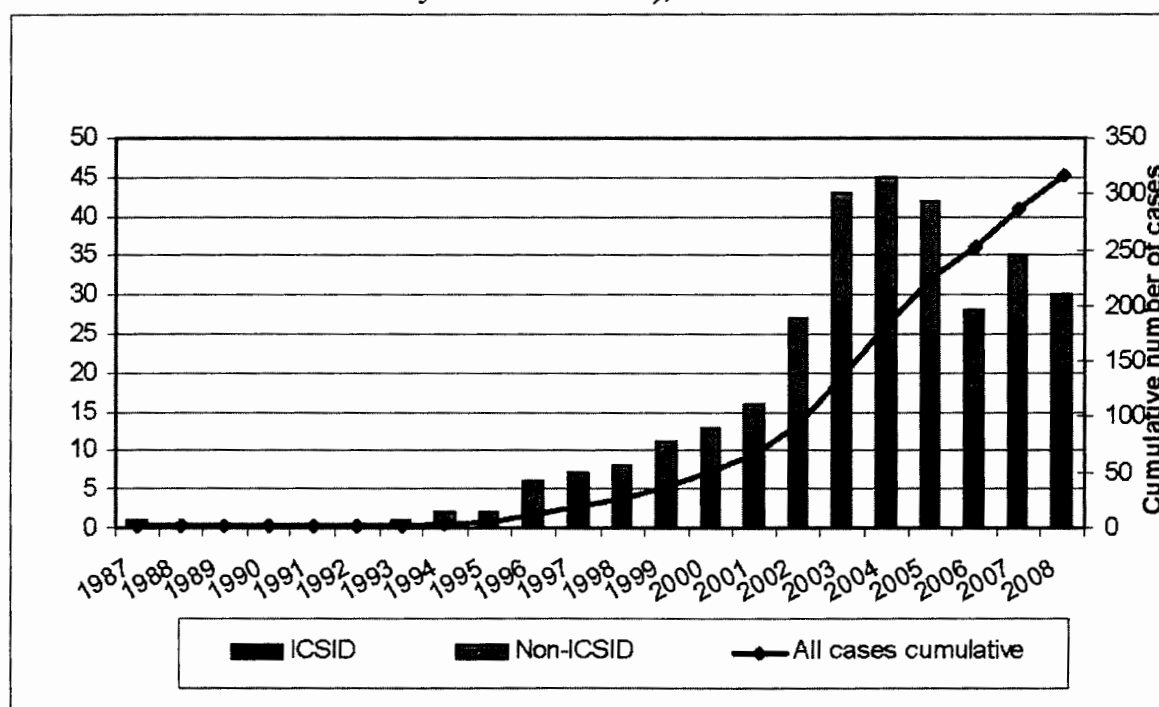
Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization ("expropriation"), except for a public purpose; in a non-discriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law. . . . Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known . . . ; be paid without delay; include interest at a commercially reasonable rate from the date of expropriation; be fully realizable; and be freely transferrable at the prevailing market rate of exchange on the date of expropriation.

In addition to these five key substantive protections for investors, the U.S.-Argentina BIT, like others, contains a mechanism of particular benefit to investors who seek to bring claims against the host state for violation of the agreement. Historically, it was difficult for foreign investors to obtain legal redress if they were injured by a host state or if the host violated an investment provision of a treaty. Litigation in the host country's courts was often fruitless, particularly when the host state could invoke sovereign immunity. Moreover, as noted in Chapter 7, traditional international law doctrine held that only states,

not individuals, could be subjects of international law, so individuals could not file international legal claims against foreign states. Instead, they had to convince their government to adopt their private grievances and espouse them on the international plane against the offending state. In practice, espousal often proved to be unsatisfactory to both claimants and states. First, states were under no legal obligation to espouse claims of their nationals, and states often declined to pursue claims due to broader foreign policy concerns. Even when claims were espoused, the injured party and the espousing state often disagreed over how to pursue the claim. Moreover, there was no guarantee that the two states would negotiate a resolution to the dispute, or that any tribunal would have jurisdiction over the dispute. Finally, states that obtained compensation were under no international legal obligation to distribute any recovery to the injured individual. For these and other reasons, the espousal process proved unattractive to most investors.

As a result, most modern investment agreements grant foreign investors the ability to file actions directly against host governments to enforce their rights and the treaty obligations of the governments. While the investor may use domestic courts, investment treaties typically permit investors to pursue their claims in binding international arbitration. Arbitral panels generally consist of three individuals, one appointed by each party and the third by the other two arbitrators. Panels can award monetary damages (with interest) and order restitution of property. The arbitrations are frequently administered by standing arbitral facilities, such as the International Centre for the Settlement of Investment Disputes, an arm of the World Bank, or the International Chamber of Commerce. With the rise in BITs providing for investor-state claims, the number of disputes has risen dramatically, as illustrated by the figure below. By the end of 2008, the disputes involved some 77 different states; approximately 90 percent of known disputes were initiated by firms headquartered in developed states. As a result of the rapidly increasing caseload, international investment law is one of the most rapidly developing areas of international legal practice.

Known investment treaty arbitrations (cumulative and newly instituted cases), 1989–2008



SOURCE: UNCTAD

C. Challenging Argentina's Actions

Foreign investors initiated more than 40 arbitral cases in response to Argentina's response to the economic crisis. These actions included four filed by U.S. firms that invested in Argentina's gas sector — CMS, LG&E, Enron, and Sempra — alleging that Argentina's actions violated the U.S.-Argentina BIT. Argentina denied that its actions breached the treaty and argued that, in any event, its responsibility for any breach was precluded on the grounds of necessity.

1. Expropriation

Chapter 2 reviewed the long-standing debate over the standard of compensation to be paid for expropriation of foreign enterprises. The Argentine gas cases, in contrast, focused upon the question of what actions constitute a compensable expropriation. Like many post-World War II investment disputes, they involved claims of indirect expropriation, or takings other than through outright nationalization or seizure of an investor's assets. The U.S.-Argentina BIT, like most BITs, does not define expropriation, and tribunals have not yet identified precisely what distinguishes permissible regulations affecting investors but requiring no compensation from government action that requires compensation.

An early NAFTA arbitral award took an expansive view of the term indirect expropriation. In *Metalclad v. Mexico*, ICSID Case No. ARB (AF)/97/1, a U.S. firm sought to construct a hazardous waste landfill in the central Mexican state of San Luis Potosí. The firm received permits from the federal government, which assured Metalclad that no state or local permits were needed. However, after work on the site started, the state government denied Metalclad a construction permit, and thereafter the municipal government obtained a court injunction prohibiting the operation of the landfill. Metalclad filed a NAFTA claim alleging an indirect expropriation. The tribunal held that indirect expropriation includes "incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property." Critics argued that the tribunal's approach ignored the state's interest in regulation and could have a chilling effect on national and local environmental regulation. However, no other tribunal has adopted the *Metalclad* test, and subsequent awards have taken a significantly narrower view of the acts that constitute an indirect expropriation.

LG&E Energy Corporation v. Argentine Republic

ICSID Case No. ARB/02/1 (Oct. 3, 2006)

188. Generally, the expression "equivalent to expropriation" or "tantamount to expropriation" found in most bilateral treaties . . . [refers to situations where] the host State's actions or conduct do not involve "overt taking" but the taking occurs when governmental measures have "effectively neutralize[d] the benefit of property of the foreign owner." Ownership or enjoyment can be said to be "neutralized" where a party no longer is in control of the investment, or where it cannot direct the day-to-day operations of the investment. As to the differences, it is usual to say that indirect expropriation may show itself in a gradual or growing form — creeping expropriation — or through a sole and unique action . . . — *de facto* expropriation.

189. In order to establish whether State measures constitute expropriation . . . the Tribunal must balance two competing interests: the degree of the measure's interference with the right of ownership and the power of the State to adopt its policies.

190. In evaluating the degree of the measure's interference with the investor's right of ownership, one must analyze the measure's economic impact — its interference with the investor's reasonable expectations — and the measure's duration.

191. . . . In many arbitral decisions, the compensation has been denied when it has not affected all or almost all the investment's economic value. Interference with the investment's ability to carry on its business is not satisfied where the investment continues to operate, even if profits are diminished. The impact must be substantial. . . .

193. Similarly, one must consider the duration of the measure. . . . Generally, the expropriation must be permanent. . . .

194. There is no doubt that the facts relating to the severity of the changes on the legal status and the practical impact endured by the investors in this case, as well as the possibility of enjoying the right of ownership and use of the investment are decisive in establishing whether an indirect expropriation is said to have occurred. The question remains as to whether one should only take into account the effects produced by the measure or if one should consider also the context within which a measure was adopted and the host State's purpose. . . . [T]here must be a balance in the analysis both of the causes and the effects of a measure in order that one may qualify a measure as being of an expropriatory nature. It is important not to confound the State's right to adopt policies with its power to take an expropriatory measure. "This determination is important because it is one of the main elements to distinguish . . . between a regulatory measure, which is an ordinary expression of the exercise of the state's police power that entails a decrease in assets or rights, and a *de facto* expropriation that deprives those assets and rights of any real substance."

195. [T]he State has the right to adopt measures having a social or general welfare purpose. In such a case, the measure must be accepted without any imposition of liability, except in cases where the State's action is obviously disproportionate to the need being addressed. . . .

198. In the circumstances of this case, although the State adopted severe measures that had a certain impact on Claimants' investment . . . [the State] did not deprive the investors of the right to enjoy their investment. . . . [T]he true interests at stake here are the investment's asset base, the value of which has rebounded since the economic crisis of December 2001 and 2002.

199. Further, it cannot be said that Claimants lost control over their shares in the licensees . . . or that they were unable to direct the day-to-day operations of the licensees in a manner different than before the measures were implemented.

200. . . . Without a permanent, severe deprivation of LG&E's rights with regard to its investment, or almost complete deprivation of the value of LG&E's investment, the Tribunal concludes that these circumstances do not constitute expropriation.

Notes and Questions

1. Does the award provide useful guidance for determining when regulatory measures constitute an expropriation? By what criteria should a tribunal decide whether a measure is "obviously disproportionate to the need being addressed"?

2. The Tribunal declares that it is to engage in a balancing act between the investor's "right of ownership" and the state's power to adopt its policies. Does the balancing act

used by the Tribunal involve inquiry into a state's intent? Should it? Several awards suggest that "[t]he government's intention is less important than the effects of the measures on the owner of the assets. . . ." *Tecmed v. Mexico*, ICSID Case No. ARB(AF)/00/2.

3. At least four tribunals considering the facts described above found no expropriation. One of the firms that pursued investor-state arbitration also made a claim that Argentina's actions constituted an expropriation under the terms of an insurance contract it had purchased from the Overseas Private Investment Corporation (OPIC), a U.S. government agency that fosters overseas investment, in part, by selling political risk insurance. OPIC found that Argentina's Emergency Law "constitute[d a] repudiation of [Argentina's] contract with [Enron], motivated by noncommercial considerations, and for which compensatory damages were not paid, in violation of [Argentina's] responsibilities to a foreign investor under international law." Why might a U.S. government agency be more apt than an arbitral tribunal to find an expropriation?

4. Since 2004, the model BIT that the United States uses in its negotiations with potential partners has included a clause providing that "[e]xcept in rare circumstances, non-discriminatory regulatory actions by a party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations." Does this language strike an appropriate balance between the rights of investors and states? Why would the United States seek to add this language to future BITs?

2. Fair and Equitable Treatment

As a historic matter, disputes over whether a host state afforded an investor fair and equitable treatment were relatively uncommon. Today, in contrast, this standard is one of the most frequently contested issues in investment disputes. Moreover, it is the ground upon which a significant number of investor claims succeed. Many cases involving fair and equitable treatment claims, including the Argentine disputes, involve challenges to administrative or executive decisions. The following excerpt exemplifies the approach tribunals took in the Argentine gas cases.

Enron Corp. v. Argentine Republic

ICSID Case No. ARB/01/3 (May 22, 2007)

259. The Tribunal is bound to interpret [the fair and equitable standard] of the Treaty "in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of the object and purpose" as required by Article 31 of the Vienna Convention. The Tribunal gives weight to the text of the Treaty's Preamble, which links the standard to the goal of legal stability: "*fair and equitable treatment of investment is desirable in order to maintain a stable framework for the investment and maximum effective use of economic resources.*"

260. Thus, the Tribunal concludes that a key element of fair and equitable treatment is the requirement of a "*stable framework for the investment*". . . .

261. This Tribunal notes, however, that the stabilization requirement does not mean the freezing of the legal system or the disappearance of the regulatory power of the State. As noted by the tribunal in *CMS* [another Argentina BIT case]:

It is not a question of whether the legal framework might need to be frozen as it can always evolve and be adapted to changing circumstances, but neither is it a question of whether the framework can be dispensed with altogether when specific commitments to the

contrary have been made. The law of foreign investment and its protection has been developed with the specific objective of avoiding such adverse legal effects.

262. The protection of the “*expectations that were taken into account by the foreign investor to make the investment*” has likewise been identified as a facet of the standard [by other arbitral tribunals]. . . . What seems to be essential . . . is that these expectations derived from the conditions that were offered by the State to the investor at the time of the investment and that such conditions were relied upon by the investor when deciding to invest.

264. The measures in question in this case have beyond any doubt substantially changed the legal and business framework under which the investment was decided and implemented. Argentina in the early 1990s constructed a regulatory framework for the gas sector containing specific guarantees to attract foreign capital to an economy historically unstable and volatile. As part of this regulatory framework, Argentina guaranteed that tariffs would be calculated in US dollars, converted into pesos for billing purposes, adjusted semi-annually in accordance with the US PPI and sufficient to cover costs and a reasonable rate of return. . . . Substantial foreign investment was undertaken on the strength of such guarantees [including Enron’s investment].

266. A decade later, however, the guarantees of the tariff regime that had seduced so many foreign investors, were dismantled. Where there was certainty and stability for investors, doubt and ambiguity are the order of the day. . . .

267. . . . It is clear that the “stable legal framework” that induced the investment is no longer in place and that a definitive framework has not been made available for almost five years.

268. Even assuming that the Respondent was guided by the best of intentions . . . there is here an objective breach of the fair and equitable treatment due under the Treaty.

Notes and Questions

1. The Tribunal places substantial emphasis on the investor’s expectations. Does, or should, an investor have to prove a causal connection between the statement relied upon and the investor’s alleged loss? Should Argentina’s history of economic instability have influenced investor expectations or were they “seduced”? Once the Argentine economy began to slide into crisis, should the investors’ expectations have changed?

2. Was the problem in the gas disputes that Argentina changed the legal framework or the degree to which it changed the framework? If the latter, does the Tribunal articulate a workable standard for distinguishing legitimate regulatory responses to changed circumstances from responses that violate fair and equitable treatment?

3. If, as the treaty language suggests, fair and equitable treatment is the minimum standard under customary international law, does that standard change over time? Governments often insist that the duty to provide fair and equitable treatment is breached only when the government’s acts “amount to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man [sic] would recognize its insufficiency,” a standard adopted by the U.S.-Mexico Claims Commission in a 1926 decision. *United States (L.F. Neer) v. Mexico*, 4 R.I.A.A. 60 (1926) (Gen. Claims Commn.). Investors have often insisted on a higher standard.

A number of recent decisions suggest that the content of fair and equitable treatment has evolved since *Neer* and that, as the *Enron* arbitrators found, “the fair and equitable standard . . . can also require [] treatment additional to, or beyond that of, customary law.

However, in a 2009 award in *Glamis Gold v. USA*, a NAFTA tribunal reviewed recent arbitral practice regarding fair and equitable treatment claims and held that the claimant had

not met its burden of proving that something other than the fundamentals of the *Neer* standard apply today. The Tribunal therefore holds that a violation of the customary international law minimum standard of treatment . . . requires an act that is sufficiently egregious and shocking — a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons — so as to fall below accepted international standards and constitute a breach of [fair and equitable treatment]. . . . The Tribunal emphasizes that, although bad faith may often be present in such a determination and its presence certainly will be determinative of a violation, a finding of bad faith is not a requirement for a breach of [the fair and equitable treatment standard].

3. Argentina's Necessity Defense

The various Argentina arbitration tribunals thus found that the state had not engaged in a compensable expropriation, but that it had violated the fair and equitable treatment standard. Argentina argued that it should nevertheless not be held liable in light of Article XI of the treaty, which provides: "This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order . . . or the protection of its own essential security interests." Argentina also argued that its actions fell within the customary international law doctrine of necessity. This doctrine was elaborated in the ILC's Draft Articles on the Responsibility of States for Internationally Wrongful Acts, adopted by the ILC in 2001. Article 25 provides

1. Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act:
 - a) Is the only way for the State to safeguard an essential interest against a grave and imminent peril; and
 - b) Does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole.
2. In any case, necessity may not be invoked by a State as a ground for precluding wrongfulness if:
 - a) The international obligation in question excludes the possibility of invoking necessity; or
 - b) The State has contributed to the situation of necessity.

As the excerpts below reveal, arbitral tribunals diverged sharply on Argentina's ability to invoke this defense.

LG&E Energy Corporation v. Argentine Republic

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205. The Tribunal's analysis to determine the applicability of Article XI of the Bilateral Treaty is twofold. First, the Tribunal must decide whether the conditions that existed in Argentina during the relevant period were such that the State was entitled to invoke the protections included in Article XI of the Treaty. Second, the Tribunal must determine whether the measures implemented by Argentina were necessary to maintain public order or to protect its essential security interests. . . .

231. Evidence has been put before the Tribunal that the conditions as of December 2001 constituted the highest degree of public disorder and threatened Argentina's essential security interests. . . . Extremely severe crises in the economic, political and social sectors reached their apex and converged in December 2001, threatening total collapse of the Government and the Argentine State.

232. All of the major economic indicators reached catastrophic proportions in December 2001. An accelerated deterioration of Argentina's Gross Domestic Product (GDP) began in December 2001, falling 10 to 15 percent faster than the previous year. Private consumption dramatically dropped in the fourth quarter of 2001, accompanied by a severe drop in domestic prices. . . . The Merval Index [of shares on the Buenos Aires Stock Exchange] experienced a dramatic decline of 60% by the end of December 2001. By mid-2001, Argentina's country risk premium was the highest premium worldwide, rendering Argentina unable to borrow on the international markets. . . .

234. While unemployment, poverty and indigency rates gradually increased from the beginning of 1998, they reached intolerable levels by December 2001. Unemployment reached almost 25%, and almost half of the Argentine population was living below poverty. . . . At the time, one quarter of the population could not afford the minimum amount of food required to ensure their subsistence. . . .

235. . . . Faced with a possible run on banks, the Government issued [a December 2001 decree limiting bank withdrawals]. The law triggered widespread social discontent. Widespread violent demonstrations and protests brought the economy to a halt, including effectively shutting down transportation systems. Looting and rioting followed in which tens of people were killed as the conditions in the country approached anarchy. . . .

237. All of these devastating conditions — economic, political, social — in the aggregate triggered the protections afforded under Article XI of the Treaty to maintain order and control the civil unrest.

238. The Tribunal rejects the notion that Article XI is only applicable in circumstances amounting to military action and war. Certainly, the conditions in Argentina in December 2001 called for immediate, decisive action to restore civil order. . . . To conclude that such a severe economic crisis could not constitute an essential security interest is to diminish the havoc that the economy can wreak on the lives of an entire population and the ability of the Government to lead. . . .

242. The Tribunal accepts that the provisions of the Emergency Law that abrogated calculation of the tariffs in U.S. dollars and PPI adjustments, as well as freezing tariffs were necessary measures to deal with the extremely serious economic crisis. Indeed, it would be unreasonable to conclude that during this period the Government should have implemented a tariff increase. . . . The severe devaluation of the peso against the dollar renders the Government's decision to abandon the calculation of tariffs in dollars reasonable. . . .

245. . . . The concept of excusing a State for the responsibility for violation of its international obligations during what is called a "state of necessity" or "state of emergency" also exists in [customary] international law. While the Tribunal considers that the protections afforded by Article XI have been triggered in this case, and are sufficient to excuse Argentina's liability, the Tribunal recognizes that satisfaction of the state of necessity standard as it exists in international law (reflected in Article 25 of the ILC's Draft Articles on State Responsibility) supports the Tribunal's conclusion.

257. The essential interests of the Argentine State were threatened in December 2001. It faced an extremely serious threat to its existence, its political and economic survival, to the possibility of maintaining its essential services in operation, and to the preservation of its internal peace. There is no serious evidence in the record that Argentina contributed to the crisis resulting in the state of necessity. In this circumstance, an economic recovery package was the only means to respond to the crisis. Although there may have been a number of ways to draft the economic recovery plan, the evidence before the Tribunal demonstrates that an across-the-board response was necessary, and the tariffs on public utilities had to be addressed. [The Tribunal also found, on the record before it, no proof that Argentina's actions caused the crisis.]

261. Following this interpretation the Tribunal considers that Article XI establishes the state of necessity as a ground for exclusion from wrongfulness of an act of the State, and therefore, the State is exempted from liability.

CMS v. Argentine Republic

ICSID Case No. ARB/01/8 (May 12, 2005)

315. The Tribunal . . . considers that Article 25 of the Articles on State Responsibility adequately reflects the state of customary international law on the question of necessity. . . .

317. While the existence of necessity as a ground for precluding wrongfulness under international law is no longer disputed, there is also consensus to the effect that this ground is an exceptional one and has to be addressed in a prudent manner to avoid abuse. . . . If strict and demanding conditions are not required or are loosely applied, any State could invoke necessity to elude its international obligations. This would certainly be contrary to the stability and predictability of the law.

320. . . . The Tribunal is convinced that the crisis was indeed severe and the argument that nothing important happened is not tenable. However, neither could it be held that wrongfulness should be precluded as a matter of course under the circumstances. As is many times the case in international affairs and international law, situations of this kind are not given in black and white but in many shades of grey.

321. It follows that the relative effect that can be reasonably attributed to the crisis does not allow for a finding on preclusion of wrongfulness. . . .

322. The Tribunal turns next to the question whether there was in this case a grave and imminent peril. Here again the Tribunal is persuaded that the situation was difficult enough to justify the government taking action to prevent a worsening of the situation and the danger of total economic collapse. But neither does the relative effect of the crisis allow here for a finding in terms of preclusion of wrongfulness.

323. A different issue, however, is whether the measures adopted were the "only way" for the State to safeguard its interests. . . . The views of the parties and distinguished economists are wide apart on this matter, ranging from the support of those measures to the discussion of a variety of alternatives, including . . . granting of direct subsidies to the affected population or industries and many others. Which of these policy alternatives would have been better is a decision beyond the scope of the Tribunal's task, which is to establish whether there was only one way or various ways and thus whether the requirements for the preclusion of wrongfulness have or have not been met.

328. The second limit is the requirement for the State not to have contributed to the situation of necessity. The [ILC] Commentary clarifies that this contribution must be

“sufficiently substantial and not merely incidental or peripheral”. . . . The Tribunal is again persuaded that similar to what is the case in most crises of this kind the roots . . . include a number of domestic as well as international dimensions. This is the unavoidable consequence of the operation of a global economy where domestic and international factors interact.

329. The issue, however, is whether the contribution to the crisis by Argentina has or has not been sufficiently substantial. The Tribunal, when reviewing the circumstances of the present dispute, must conclude that this was the case. The crisis was not of the making of one particular administration and found its roots in the earlier crisis of the 1980s and evolving governmental policies of the 1990s that reached a zenith in 2002 and thereafter. Therefore, the . . . government policies . . . significantly contributed to the crisis and the emergency and while exogenous factors did fuel additional difficulties they do not exempt the Respondent from its responsibility. . . .

355. As stated above, the Tribunal is convinced that the Argentine crisis was severe but did not result in total economic and social collapse. When the Argentine crisis is compared to other contemporary crises affecting countries in different regions of the world it may be noted that such other crises have not led to the derogation of international contractual or treaty obligations. Renegotiation, adaptation and postponement have occurred but the essence of the international obligations has been kept intact.

After rejecting Argentina's defense, the Tribunal awarded CMS compensation of \$133.2 million, and required Argentina to purchase CMS's shares in its Argentine investment for an additional \$2.15 million.

Notes and Questions

1. Which opinion do you find more persuasive? What types of circumstances would justify a necessity defense?

2. Assuming that a measure is justified by necessity, should compensation be due to the investor? In dicta, the CMS panel held that “the plea of necessity may preclude the wrongfulness of an act, but it does not exclude the duty to compensate the owner of the right which had to be sacrificed.” *LG&E* concluded, in contrast, that “the damages suffered during the state of necessity should be borne by the investor.” As a policy matter, which is the preferable approach to this issue?

3. The customary international law doctrine of necessity is discussed in the *Israeli Wall* decision in Chapter 8 and the *Gabcikovo* opinion in Chapter 11. Are the treatments of the necessity doctrine consistent across these decisions?

D. Challenges to Investor-State Arbitration

The Argentine gas disputes are not the only high-visibility cases to generate divergent outcomes. In *Lauder v. Czech Republic*, decided under the U.S.-Czech BIT in September 2001, a tribunal found that the state did not expropriate the claimant's property when it eliminated the claimant's exclusive right to operate a television station. In *CME v. Czech*

Republic, decided under the Netherlands-Czech BIT ten days later, a tribunal considering the same facts held that the contract revision constituted a compensable expropriation and awarded damages of more than \$269 million.

These disputes illustrate some of the practical, doctrinal, and policy pressures facing the investor-state arbitration system. Although many of the substantive issues are not new, the range of actors making claims, the venues for their resolution, and the outcomes of these processes are increasingly diverse. Controversial and, at times, contradictory outcomes have led various actors in this process to raise a number of pressing questions: Can investment tribunals legitimately and persuasively resolve the increasingly complex set of claims that come before them, particularly given the highly politicized nature of many of them? Do the broad provisions in investment treaties unduly encroach on host state regulatory authority? Do adequate mechanisms exist for managing parallel proceedings involving the same facts or the issuance of conflicting awards? Is it legitimate that investors can use such tribunals against host states, but host states cannot use them to enforce any duties on the investor? In short, is the highly decentralized system of dispute resolution well suited to meet contemporary challenges, or is it an example of the so-called fragmentation of international law, as discussed in Chapter 1?

BIT provisions for investor-state arbitration represent a delegation of authority to resolve a particular class of dispute in certain prescribed ways. Given the increasing importance of investment arbitration, in recent years substantial diplomatic and scholarly attention has been devoted to the desirability of creating a new control mechanism to ensure that investment tribunals act legitimately and effectively. The materials that follow explore several facets of this issue.

1. Review of Arbitral Awards

Depending on the rules governing the arbitration, the review of awards may be left to international tribunals or to national courts. Many investor-state claims are pursued under rules promulgated by the International Centre for the Settlement of Investment Disputes (ICSID), a treaty-based institution. Under the 1965 treaty creating ICSID, domestic courts do not have authority to stay, compel, review, or otherwise influence ICSID tribunals. At the same time, the ICSID Convention provides a limited mechanism for challenging awards. Under this procedure, an ad hoc committee of arbitrators may annul the award upon the request of a party. Annulment is concerned with the legitimacy of the decision-making process, not with the substantive correctness of the award. Article 52 of the ICSID Convention provides that annulment can occur on one or more of the following grounds:

- (a) that the Tribunal was not properly constituted;
- (b) that the Tribunal has manifestly exceeded its powers;
- (c) that there was corruption on the part of a member of the Tribunal;
- (d) that there has been a serious departure from a fundamental rule of procedure; or
- (e) that the award has failed to state the reasons on which it is based.

The excerpt below, from a proceeding seeking annulment of the CMS arbitral award excerpted on page 818, emphasizes that annulment should be sharply distinguished from appeal.

CMS v. Argentine Republic

ICSID Case No. ARB/01/08 (Sept. 25, 2007) (Annulment Proceeding)

43. Both parties recognize that an *ad hoc* committee is not a court of appeal and that its competence extends only to annulment based on one or other of the grounds expressly set out in Article 52 of the ICSID Convention.

45. . . . The present arbitration was the first of a long series relating to the Argentine crisis of 2001-2002. Accordingly the Committee will seek to clarify certain points of substance on which, in its view, the Tribunal made manifest errors of law. It remains to be seen, however, whether as a consequence the award should be annulled.

(ii) *Manifest excess of powers*

129. The Committee observes first that there is some analogy in the language used in Article XI of the BIT and in Article 25 of the ILC's Articles on State Responsibility. The first text mentions "necessary" measures and the second relates to the "state of necessity". However Article XI specifies the conditions under which the Treaty may be applied, whereas Article 25 is drafted in a negative way: it excludes the application of the state of necessity on the merits, unless certain stringent conditions are met. Moreover, Article XI is a threshold requirement: if it applies, the substantive obligations under the Treaty do not apply. By contrast, Article 25 is an excuse which is only relevant once it has been decided that there has otherwise been a breach of those substantive obligations.

130. Furthermore Article XI and Article 25 are substantively different. The first covers measures necessary for the maintenance of public order or the protection of each Party's own essential security interests, without qualifying such measures. The second subordinates the state of necessity to four conditions. In other terms the requirements under Article XI are not the same as those under customary international law as codified by Article 25, as the Parties in fact recognized during the hearing before the Committee. On that point, the Tribunal made a manifest error of law.

131. Those two texts having a different operation and content, it was necessary for the Tribunal to take a position on their relationship and to decide whether they were both applicable in the present case. The Tribunal did not enter into such an analysis, simply assuming that Article XI and Article 25 are on the same footing.

132. In doing so the Tribunal made another error of law. One could wonder whether state of necessity in customary international law goes to the issue of wrongfulness or that of responsibility. But in any case, the excuse based on customary international law could only be subsidiary to the exclusion based on Article XI.

135. [The] errors made by the Tribunal could have had a decisive impact on the operative part of the Award. . . . If the Committee was acting as a court of appeal, it would have to reconsider the Award on this ground.

136. The Committee recalls, once more, that it has only a limited jurisdiction under Article 52 of the ICSID Convention. In the circumstances, the Committee cannot simply substitute its own view of the law and its own appreciation of the facts for those of the Tribunal. Notwithstanding the identified errors and lacunas in the Award, it is the case in the end that the Tribunal applied Article XI of the Treaty. Although applying it cryptically and defectively, it applied it. There is accordingly no manifest excess of powers.

Senior Argentine officials have stated that it will be both economically and politically difficult for the government to pay in excess of \$130 million to satisfy an arbitral award

that has been authoritatively determined to be legally erroneous. As of early 2010, Argentina had not paid the award, and CMS transferred the award to a Bank of America subsidiary specializing in the collection of distressed debt.

Notes and Questions

1. The CMS annulment committee emphasized that it did not sit as a court of appeals. Why did it state that the underlying CMS award contained outcome-determinative errors? Was this statement a signal to the dozens of other arbitral panels considering claims against Argentina? Did the committee provide useful guidance to them regarding the relationship between Article XI of the BIT and the customary international law defense of necessity?

2. Does the ICSID annulment procedure strike an appropriate balance between the interest in finality and the interest in substantively correct outcomes?

3. The large awards rendered in *CMS* and some other investment disputes have sparked a backlash against investor-state arbitration. Evo Morales, President of Bolivia, stated that "Governments from Latin America and I think all over the world never win the cases. The transnationals always win." In May 2007, Bolivia formally denounced the ICSID Convention. In July 2009, Ecuador denounced the Convention, and both Venezuela and Nicaragua have threatened to follow suit. In addition, a number of states are considering omitting investor-state arbitration provisions from future BITs.

2. An Appellate Mechanism?

Some critics of investor-state arbitration have argued that an appellate mechanism could correct for legal errors in arbitral awards, address inconsistent awards, and help ensure consistency in the interpretation of common terms such as expropriation and fair and equitable treatment. The idea gained some traction in the United States after the initiation of controversial NAFTA investor-state claims against the United States. The 2002 law granting the President authority to negotiate trade agreements provided:

The principal negotiating objectives of the United States regarding foreign investment are . . . to secure for investors important rights that would be available under United States legal principles and practice, by . . . providing for an appellate body or similar mechanism to provide coherence to the interpretations of trade agreements.

Thereafter, the U.S.-Singapore, U.S.-Chile, and U.S.-Morocco free trade agreements stated that within three years after the agreements entered into force, the parties "shall consider whether to establish a bilateral appellate body or similar mechanism" to review investor-state arbitral awards. The free trade agreement between the United States, Central American states, and the Dominican Republic calls for establishment of a "Negotiating Group to develop an appellate body or similar mechanism."

In 2004, the ICSID Secretariat issued a "discussion paper" calling for an "appellate mechanism" to provide coherence and consistency in investor-state awards. Perhaps reflecting the controversial nature of this proposal, a later version of the discussion paper does not mention the proposal. The passage below, taken from an OECD discussion paper, reviews the arguments for and against an appellate mechanism.

B. Why an appeal mechanism in investment disputes? Advantages and disadvantages

i) Advantages

38. One of the main advantages for the creation of an appellate mechanism advanced by its proponents is consistency. Consistency and coherence of jurisprudence create predictability and enhance the legitimacy of the system of investment arbitration. The inconsistent decisions based on the same or similar facts . . . have attracted widespread attention. While there is no guarantee that the inconsistencies would have been avoided if these awards had been submitted subsequently to an appeal, the chances for consistency would be reinforced by the existence of a common appeals body which would handle not only ICSID awards, but also . . . awards rendered by [other tribunals].

39. The notion of consistency has been viewed to go beyond the situation when two panels constituted under different agreements deal with the same set of facts and give conflicting opinions or reach a different conclusion. It might also encompass coherence of interpretation of basic principles which may underlie differently worded provisions in particular agreements and therefore might enhance the development of a more consistent international investment law. . . .

41. Another possible advantage is to allay public concern that awards affecting important public policy issues and interests could be enforced despite serious error. This could enhance support for investor-state arbitration at a time of growing numbers of cases.

43. The creation of an appeal mechanism would uphold the principal advantage of investor-state dispute settlement: the review of investment awards . . . would be confined to neutral and qualified tribunals which would operate on the basis of international standards and procedures instead of taking place in domestic courts which may have a local bias or be subject to governmental influences.

ii) Disadvantages

47. The finality of arbitration proceedings, i.e., that an arbitration award is binding and not open to appeal on the merits, has generally been seen as one of the major advantages of arbitration over judicial settlement. The "final" award puts an end to the parties' conflict and related dispute settlement expenses in a limited period of time.

49. The existence of an appeal mechanism could result in additional costs and delays in the resolution process. With respect to delays, however, there was a view that there are already considerable delays in the set aside proceedings under the national court systems which[,] given the existence of different layers of appeal (first instance, appeal court, supreme courts), could take years before a final decision is rendered. . . .

52. By including additional grounds to the ones under the current annulment and review procedures, an appeal in investment disputes could result in a greater number of challenges to arbitral awards. There was a concern that there would be a tendency to appeal in every case, which would result in decreasing confidence in the main body of decisions and the authority of the "first instance" arbitrators.

54. . . . [T]he de-politicisation of investment disputes, considered one of the main achievements of investor-to-state arbitration, could be undermined. . . . [G]overnments, to please [] their constituencies, are likely to appeal on every case

they lose in the first instance and they would be the main beneficiaries of the system. In addition, it was argued that if the choice of appellate arbitrators is made by the states only, there is a risk of bias against investors.

Notes and Questions

1. Are you persuaded of the need for an appellate mechanism? If so, what standard of review should an appellate body use?

2. Does the possibility of inconsistent awards justify creation of an appellate body? Consider the following:

Some questions are eternal. To take the issue of compensable regulatory measures — or those of . . . minimum standards of fairness, denial of justice, or discrimination — they are simply immune to resolution by abstraction. . . . I [believe] that the same [irreducible] indeterminateness would be generated by appellate investment adjudicators.

. . . When critics of international arbitration bemoan the lack of consistency and coherence, they are blaming the process for failing to achieve the impossible. . . . [T]he hidden agenda needs to come out: what is being questioned is the very concept of neutral international adjudication and its necessary constraint on sovereignty.

Jan Paulsson, *Avoiding Unintended Consequences*, in *Appeals Mechanism in International Investment Disputes* (Karl P. Sauvant ed., 2008).

3. NAFTA contains another mechanism that states can use to address the reasoning and outcomes of investment disputes. NAFTA establishes a trilateral intergovernmental Free Trade Commission (FTC). The Commission has the authority to issue interpretations of NAFTA provisions that are binding upon investor-state arbitration tribunals. Thus, for example, after three NAFTA tribunals determined that the “fair and equitable treatment” standard in the treaty imposed a higher duty on states than that imposed by customary international law, the FTC issued a Note of Interpretation rejecting this conclusion and stating that the treaty required only “the customary international law minimum standard of treatment.” Thereafter, NAFTA panels deemed the FTC Note to be controlling on this issue. Is this type of party control over tribunal interpretations preferable to an appellate mechanism?

4. Is the model of international commercial arbitration, including party-appointed arbitrators, well designed to address the numerous public policy issues in investment disputes? Would a permanent investment court, along the lines of the European Court of Human Rights, be a better model?