ECONOMIC STATECRAFT AND INVESTMENT ARBITRATION

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ABSTRACT

According to economic statecraft theory, states use investments by state-owned enterprises (“SOEs”) to achieve geopolitical objectives, such as securing control over resources or exercising influence in zones of special strategic interest. There is increasing interest about the geopolitics of foreign investments under the Chinese and Russian infrastructure diplomacy. Geopolitical investments pose a challenge to investment arbitration—a mechanism created to depoliticize the resolution of investor-state disputes. This article argues that, in the context of growing economic power of SOEs and increasing geopolitical tensions, geopolitics cannot and should not be excluded from the investment arbitration process. At the jurisdictional stage, it makes sense to focus on the commercial nature of investments in strategic sectors, given the difficulty of establishing the real motivation of foreign investors on the basis of objective criteria. However, on the merits, geopolitical arguments are often the only basis on which host states can substantiate their security concerns regarding foreign control over strategic assets. Excluding geopolitical analysis from investment arbitration would negatively affect host states’ defense of regulatory interference with strategic investments.

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1. INTRODUCTION

The objective of this article is to propose a new interdisciplinary perspective to the study of investment arbitration based on the theories of “economic statecraft” (i.e., the study of economic activities as instruments of foreign policy) and “geopolitics” (i.e., the study of interstate competition for territory, resources, and security). As highlighted by opposition to certain Chinese investments in OECD countries, host states perceive the economic power of SOEs from emerging economies as a potential risk to their own national security. This concern finds support in a growing body of literature on economic statecraft, according to which certain states use SOEs to achieve geopolitical objectives. Foreign investments by SOEs can be made to secure control over resources, obtain political concessions, or exercise influence in zones of special interest. To protect national security, host states can block the

1 See David A. Baldwin, Economic Statecraft 9 (1985) (stating that to study statecraft is to consider the instruments used by policy makers in their attempts to exercise power).


3 See James Kynge et al., Western Resistance to China Blocks $40bn of Acquisitions, Fin. Times (Oct. 25, 2016), at 1 (stating that since mid-2015, “Western” countries blocked approximately $40 billion dollars of Chinese acquisitions, mainly in response to security concerns).

4 See, e.g., Tom Miller, China’s Asian Dream: Empire Building Along The New Silk Road 13 (2017) (examining China’s use of SOEs to expand its geopolitical influence); Robert D. Blackwill & Jennifer M. Harris, War By Other Means: Geoeconomic And Statecraft 1–18, 20 (2016) (observing that some “states are currently applying economic instruments to advance geopolitical ends”). See also Baldwin, supra note 1, at 42–43 (providing examples of economic statecraft); Nicholas J. Spykman, America’s Strategy In World Politics: The United States and The Balance of Power, 12 (1970) (citing persuasion, purchase, barter, and coercion as four main methods to win friends and influence people). See generally William J. Norris, Chinese Economic Statecraft: Commercial Actors, Grand Strategy, and State Control (2016).

5 See, e.g., Blackwill & Harris, supra note 4, at 53–58 (observing that a large number of state-led investments are geopolitically motivated, and that even those which are not can have geopolitical consequences); Norris, supra note 4, at 82 (referring to the use of oil reserves as an example in which the state relies on finance to secure strategic resources); Gerry Kearns, Geopolitics and Empire: The Legacy of Halford Mackinder 268 (2009) (describing how SOEs are used for imperialism); Aad Correljé & Coby van der Linde, Energy Supply Security and Geopolitics: A
acquisition of strategic assets by SOEs from states perceived as unfriendly. They can also re-regulate existing investments in the case of deterioration of bilateral relations with the home state of the SOE (e.g., forced disinvestment or renegotiation of the investment agreement). The economic statecraft and geopolitical theories help host states to understand the security risks of investments by SOEs, and help SOEs to anticipate the risk of state interference.

The special nature of SOEs and the security risks they pose to host states are also examined in investment law literature, with a focus on governance principles, national security reviews, and the access of SOEs to investment arbitration. It is a principle of international economic governance that state-owned investment vehicles should aim to maximize financial returns and operate on the basis of sound asset management principles. In the absence of liberalization commitments, governments can, at the pre-establishment stage, exercise broad discretion and exclude investments which are perceived to be motivated by unfriendly intentions. At the post-establishment stage, state anxieties regarding the perceived security risks of SOEs can result in discriminatory action, which the SOEs can challenge through

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*European Perspective, 34 ENERGY POLICY 532, 536 (2006) (noting the impact of SOEs on the security of energy supply to the EU).*


investment arbitration. Given the close link between SOEs and their home state governments, the access of SOEs to arbitration challenges the core objective of investor-state dispute resolution, to insulate investors’ claims “from political and diplomatic relations between states” and remove the home state from the arbitration process.

Despite their common object of study, the investment law and economic statecraft literatures have remained largely disconnected from each other. On the one hand, investment law analyses recognize that SOEs can pose a challenge to national security, without examining the geopolitical roots of this security problem. On the other hand, geopolitical studies only rarely engage with the legal dimension of strategic investments and pay little attention to the possible protection of SOEs under investment arbitration. In the gap between these two disciplines, an essential dimension to the understanding of investment arbitration is lost.

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9 See Paul Blyshak, *State-Owned Enterprises and International Investment Treaties: When Are State-Owned Entities and their Investments Protection*, 6 J. INT’L L. & INT’L Rel. 1, 14 (2011) (noting that SOEs may be subject to discriminatory or arbitrary treatment and emphasizing on the importance to determine the standing of SOEs to bring investment arbitration claims); UNCTAD, *supra* note 6, at 30–32 (reminding that national security considerations can affect investments).


11 See Lauge N. Skovgaard Poulsen, *States as Foreign Investors: Diplomatic Disputes and Legal Fictions*, 31 ICSID Rev. 12 (2016) (highlighting foreign investments made by states and their effects on investment treaty arbitrations). See also Martins Paparinskis, *The Limits of Depoliticisation in Contemporary Investor-State Arbitration*, in *SELECT PROCEEDINGS OF THE EUROPEAN SOCIETY OF INTERNATIONAL LAW 271* (James Crawford & Sarah Nouwen eds., 2010) (describing different dimensions of and limits to the “depoliticization” objective of investment arbitration depending on whether the perspective of the home state, the host state, or the investor is taken).


The main argument of this article is that, in a context of the growing influence of SOEs and the strategic use of foreign investments by certain states, geopolitical analysis plays a role in the resolution of disputes concerning strategic investments. In the analysis on jurisdiction, the relevance of geopolitical arguments is limited. Arbitral tribunals can be reluctant to refuse jurisdiction on the basis of the perceived geopolitical motivation of a SOE, thus opening the door to the arbitration of geopolitical and state-to-state disputes. The home state government, through its control of the SOE, can indirectly be involved in an investor-state dispute resolution concerning geopolitical issues. However, in an analysis on the merits, geopolitical arguments are often the only basis through which a host state can justify regulatory interference with a strategic investment by a SOE in the context of tensions between its home state and the host state. The economic statecraft and geopolitical theories provide a rational framework to assess the reasonableness of security measures and can thus contribute to disciplining arbitrary measures under investment arbitration, e.g., the politically motivated retaliation against a SOE in the context of interstate tensions.

The structure of the argument proceeds as follows. Section II starts with an introduction to the economic statecraft and geopolitical theories, and, in particular, to the role of foreign investment by SOEs as instrument of geopolitics. On this basis, section III (on jurisdiction) examines the question of access of geopolitical investors to arbitration. Building on the existing literature on the access of SOEs to arbitration, the analysis focuses on the extent to which state control and the possible geopolitical motivation of investments prevent investor-state dispute settlement. Section IV (on merits) studies the relevance of geopolitical arguments for the application of substantive standards of investment protection to the regulation of the perceived security risks of existing investments (post-establishment). Security reviews to control the access of foreign investors to strategic industries (pre-establishment) are not the focus of this article.

2. A GEOPOLITICAL PERSPECTIVE TO FOREIGN INVESTMENT

The relevance of geopolitical analysis for investment law depends on a clear delimitation of the notion of “economic statecraft,” “geopolitical investment,” and “geopolitical risk.” From
the state’s perspective, it is essential to define these notions to help the government understand and address the security risks that the country faces. From the investor’s perspective, a clear delimitation of the notion of “geopolitical risk” is important to restrict the scope of government interference with its investments. Indeed, the concept of geopolitics is a “powerful rhetorical tool” that can “mobilise materialist or militarist visions of international security.” For instance, references to the use of “energy as a foreign political weapon” and “gas wars” are common in the analysis of foreign investment and trade in the strategic energy sector.

2.1. Economic Statecraft and Geopolitical Investments

Economic statecraft refers to the use—or abuse (i.e., manipulation)—by states of economic instruments (e.g., investments) as an alternative to military power and classical diplomacy to achieve geopolitical results. “Infrastructure diplomacy” replaces or complements “gunboat diplomacy” as an instrument of geopolitical influence.

Although the notion of geopolitics is the subject of controversy, the literature generally agrees that, within its broad meaning,
geopolitics concerns the interaction between geographical attributes (spatial location, size, topography, borders, climate, and distribution of resources) and international political power. The “geopolitical reality” is defined by “the geographic distribution of centers of resources and lines of communication, assigning value to locations according to their strategic importance.” Geopolitical analysis helps us to understand the practice of states competing for territory and resources, and defending their national security. The strategic importance of certain resources and locations for national security drives states to develop foreign policies to achieve control over these resources and protect their strategic interests in these locations.

Geopolitics, within the progressive meaning of the term, covers the use of soft power instruments, including foreign investments by SOEs in sectors of strategic importance. SOEs can act as “geopolitical investors” by making investments that pursue strategic interests.

In the energy sector, for instance, foreign investments by SOEs can aim to achieve the strategic objectives of energy security and increased influence in zones of special strategic interest. First, by investing in energy-producing states and developing cross-border pipeline infrastructures, SOEs from energy-importing states (e.g., China’s CNPC) contribute to the availability of external energy while the term geopolitics classically referred to territorial conquests, the term has evolved in modern times and is now broader in scope.

19 See Saul Bernard Cohen, Geopolitics: The Geography of International Relations 16 (3d ed. 2015) (recognizing the importance of geography’s role in modern geopolitics and international affairs); Geoffrey Parker, Geopolitics: Past, Present and Future 5 (1998) (defining geopolitics as the study of international relations from a spatial or geographic perspective).

20 See Flint, supra note 2, at 31 (providing sources that reflect the scope of the geopolitical framework); Grygiel, supra note 2, at 39 (arguing that states have various motivations to control borders and economic resources).

21 See, e.g., Blackwill & Harris, supra note 4, 53–58 (noting an impact on international relations when SOEs invest in foreign countries); Kearns supra note 5, at 268 (discussing multinational corporations and their effects on the labor laws of the foreign countries where they invest); Correljé & van der Linde, supra note 5, at 536 (arguing that regional powers create spheres of influence through bilateral trade relationships in energy).

22 See Andreas Goldthau & Nick Sitter, A Liberal Actor in a Realist World 4 (2015) (discussing the changing dynamics of post-Cold War energy policies and their effect on international affairs).
sources for the home state.\textsuperscript{24} The mandate by the state to secure external energy supplies explains decisions to invest in high-risk markets where commercially-driven companies can be reluctant to operate (e.g., Central Asia).\textsuperscript{25} Second, SOEs from energy-exporting countries (e.g., Russia’s Gazprom) engage in the development of infrastructure in order to secure the future demand for their energy products, and thereby to protect the financial viability of their investments in new oil and gas fields.\textsuperscript{26} These projects (e.g., the Nord Stream pipeline linking Russia to the EU by bypassing Ukraine) are often criticized for locking the importing countries into a relationship of energy dependence.\textsuperscript{27} Third, states can use foreign energy investments to exercise broader geopolitical influence. Similarly to the subsidization of energy supply in exchange for geostrategic allegiance,\textsuperscript{28} analysts explain Russian investments in the downstream energy infrastructure of post-Soviet countries (e.g.,


\textsuperscript{25}See, e.g., Hinrich Voss, \textit{The Determinants of Chinese Outward Direct Investment} 133 (2011) (hypothesizing that Chinese government policies account for a positive correlation between countries with higher risk and Chinese foreign investment in those countries).


power plants in Central Asia) are based on Russia’s geopolitical interest in retaining these countries within its sphere of influence.\(^29\) Furthermore, analysts explain Chinese investments in the downstream energy infrastructure of its neighbors based on China’s strategic interest to maintain political stability in its “strategic rear.”\(^30\) China’s participation in facilitating the energy security of its strategic partners is an important part of China’s “good neighborhood” policy and, more recently, its “Belt and Road” (New Silk Road) initiative.\(^31\)

Although analysts generally agree that geopolitical objectives (energy security and strategic influence) are an important rationale of foreign investments by Russian SOEs, analysts disagree on whether geopolitics constitute the only or dominant driver of these investments. Some consider Gazprom’s investments in the EU energy market as being driven by “fairly conventional profit


\(^{30}\) On China’s “strategic rear,” see, e.g., Zhao Huasheng, Central Asia in Chinese Strategic Thinking, in THE NEW GREAT GAME: CHINA AND SOUTH AND CENTRAL ASIA IN THE ERA OF REFORM 171, 177–85 (Thomas Fingar ed., 2016) (describing Chinese government efforts to secure gas supplies from Central Asia, which is described as territory within Russia’s zone of influence); Thomas Fingar, China and South and Central Asia in the Era of Reform and Opening, in THE NEW GREAT GAME: CHINA AND SOUTH AND CENTRAL ASIA IN THE ERA OF REFORM 13 (Thomas Fingar ed., 2016) (arguing that when deciding to engage with other countries, the Chinese government rely on the effect that the engagement would have on its security and internal stability). See generally MARLÈNE LARUELLE & SEBASTIEN PEYROUSE, THE CHINESE QUESTION ON CENTRAL ASIA: DOMESTIC ORDER, SOCIAL CHANGE, AND THE CHINESE FACTOR (2012).

\(^{31}\) CHIEN-PEN CHUNG, CHINA’S MULTILATERAL COOPERATION IN ASIA AND THE PACIFIC: INSTITUTIONALISING BEIJING’S “GOOD NEIGHBOUR POLICY” (2010) (describing China’s policy of creating good network relations with its neighboring countries); M\(\text{I}\)LLER, supra note 4, at 21–43 (examining China’s use of SOEs for its “Belt and Road” initiative).
motives, albeit under conditions of geopolitical uncertainty.” Others argue that Russian SOEs “serve the purposes of Russia’s foreign policy rather than commercial logic.” The Nord Stream 2 project, for instance, is “not a commercial project only; it has huge political implications.” Similarly, the rationale for outbound investments by Chinese SOEs is often defined based on a mix of geopolitical and commercial interests. According to Fitch Rating’s 2017 report on China’s “Belt and Road” (OBOR) initiative, “genuine infrastructure needs and commercial logic might be secondary to political motivations. OBOR . . . is a component of China’s efforts to


expand its strategic international influence.”

Geopolitical investments in the energy sector are thus often “hybrid” or “chameleon” investments.

2.2. Geopolitical Risk, Security Externalities, and Regulatory Changes

With the exception of climate change and boundary adjustments following drastic political changes, geographical attributes are mostly constant. However, geopolitics are dynamic. Geopolitical reality changes with the rise and decline of resources, routes, and locations. Technological, economic, and political developments alter the strategic importance of locations, and this can trigger the re-orientation of a state’s foreign policies towards these locations. To an important extent, the re-orientation of a state’s external strategy depends on the frame of reference (or “geopolitical code”) that governs the government’s interpretation of geopolitical developments. Changes to geopolitical reality are relatively slow and irrevocable, but decisions of strategic re-orientation based on the national authorities’ interpretation of geopolitical reality can be sudden. The dynamic nature of geopolitics constitutes both a security risk for host states and a regulatory risk for investors.

From the host state’s perspective, the deterioration or re-orientation of the bilateral relationship with the home state of the SOE can create new security risks in cases where strategic assets are

36 FitchRatings, China’s One Belt, One Road Initiative Brings Risks (Jan. 25, 2017), www.fitchratings.com/site/pr/1018144 [https://perma.cc/FC5D-JQJ3].


39 See Nicholas Spykman, Geography and Foreign Policy, 1 AM. POL. SCI. REV. 28, 43 (1938) (describing how every country’s perception of international relations changes with its geographical location).

40 Id. See also FLINT, supra note 2, at 43 (listing changes in economic strength and military costs as a challenge to world leadership).
concerned. Following shifts in strategic alliances, the host state can perceive investments by the SOE from a previously allied state as a new “security externality” that requires regulatory intervention.

For foreign investors in strategic assets, the host state’s perception of changes to the geopolitical context and the perceived necessity to mitigate the security risks resulting from the deterioration of interstate relations are significant regulatory risks. In more extreme cases, the host state can be tempted to retaliate against foreign investments by SOEs to punish the home state in the context of interstate tensions. The EU-Russian energy relationship illustrates how foreign investments in strategic assets can be affected by (allegedly politically motivated) regulatory intervention taken in the context of deteriorating bilateral relations between the home and host states.

For decades, the EU’s dependence on Russian energy was not considered a direct threat to EU energy security. The EU’s energy policy has long sought to achieve the “mutual long term benefits” of EU-Russian energy interdependence by intensifying commercial and political cooperation.

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41 See UNCTAD, supra note 6, at 17 (arguing that national security concerns can be particularly strong in relation to foreign investors from states with which the host state has unfriendly relations); Desbordes & Vicard, supra note 6, at 373 (arguing that multinational enterprises may face certain risks arising due to political relations between the home and host state).

42 See Stephen Walt, The Origins Of Alliances (1987) (arguing that a state’s perception of threat is more important than pure power in determining threats and alliance behavior); see also Andrew Kydd, Trust and Mistrust in International Relations (2005) (noting variables affecting states’ trust, including SOEs); Srikanth Kondapalli, Perception and Strategic Reality in India-China Relations, in Huasheng, supra note 30, at 93, 96 (describing relations between India and China as “marked by suspicion, ambivalence, and hedging”).

43 See, e.g., Norris, supra note 4, at 12–13 (using economic theory of externalities to describe the relationship between economics and national security); Abdelal, supra note 32, at 426 (noting that the interests of energy oligopolies can conflict with the security concerns of the state).

44 For a historical account, see, e.g., Andrei V. Belyi, Transnational Gas Markets and Euro-Russian Energy Relations (Timothy M. Shaw ed., 2015) (examining EU-Russia energy interdependence and its impact on Euro-Russian relations over time); Per Høgselius, Red Gas: Russia and the Origins of European Energy Dependence (Akira Iriye & Rana Mitter eds., 2013) (analyzing the evolution of the Soviet natural gas infrastructure and its interconnection with European energy markets).

reduced, but managed. Russian energy companies invested in the EU energy market and EU companies invested in Russia. However, successive Russia-Ukraine crises negatively affected the EU’s perception of Russian energy and seriously damaged the EU-Russian energy relationship. According to the 2014 European Energy Security Strategy, “the most pressing energy security of supply issue is the strong dependence from a single external supplier,” which, in the EU’s case, is Russia.

The deterioration of the EU-Russian energy relationship and the perception of risk regarding the EU’s external energy dependence triggered the EU’s adoption of regulatory measures directed at addressing this concern. Most notably, in 2009, the EU introduced an energy security review mechanism—the “Gazprom clause”—to evaluate the risk that non-EU investors pose to the security of the EU energy sector. A key element in this energy security assessment is the level of energy dependence between the EU and the home country of the applicant—a criterion that de facto targets Russian energy investors by taking into account EU dependence on


50 Id. at recital 22 (examining EU energy dependence on States outside the EU and highlighting the importance of securing the supply of energy within EU Member States).
Russian imports. In addition to the Gazprom clause, EU member states have implemented measures for ownership unbundling of energy activities (i.e., separation of control over network and supply assets). These measures directly interfered with the business model of Gazprom in the EU. In reaction, Gazprom, a Russian company, initiated investment arbitration proceedings to contest the implementation of these measures in Lithuania. Russia also regularly accuses the EU Commission of engaging in “politically motivated interpretations of EU regulation” aimed at “expropriating Gazprom’s assets” in the EU.

Similarly, policy analysts note a risk to Chinese energy investments stemming from political and regulatory intervention by host States who perceive China’s increasing influence in the host State as a threat. Recent riots in Kazakhstan against Chinese investments highlight China’s susceptibility to the risk of “resource nationalism,” namely, the risk of Kazakhstan nationalizing Chinese investments to address public anger about a perceived “takeover”...

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53 Goldthau, *supra* note 13, at 22.


55 See Duchâtel, et al., *supra* note 35, at 25-26 (examining China’s foreign policy shift from non-interference to pragmatic intervention).
of national resources by China.\textsuperscript{56} As highlighted by the \textit{China Heilongjiang International v. Mongolia} arbitration case, public opposition to increasing dependence on China can result in the sudden cancellation of licenses previously granted to Chinese companies for the exploration and exploitation of national resources.\textsuperscript{57}

In this strategic context, can state-owned investors in projects of geopolitical importance challenge state interference with their investments through international arbitration mechanisms?

3. JURISDICTION: ACCESS OF GEOPOLITICAL INVESTORS TO INVESTOR-STATE ARBITRATION

The protection of state-owned investors is central in the debate on the commercial nature and limits of investment arbitration.\textsuperscript{58} The


participation of SOEs in investment arbitration presents a challenge to the investment law discipline relating to the role of the state as claimant in investor-state disputes. The question of access of “geopolitical investors” to arbitration is closely related to this debate. In addition to the issue of state ownership, the protection of geopolitical investors involves strategic (i.e., not purely commercial) considerations. Do state ownership and the pursuit of non-commercial objectives bar access to arbitration? Alternatively, does investment arbitration—a mechanism created to remove the home state from investor-state dispute resolution—provide a forum for the settlement of disputes with geopolitical characteristics?

Access to arbitration first depends on the claimant’s qualification as an “investor” within the meaning of the applicable investment treaty. Investment treaties that expressly refer to SOEs in the definition of “investors” are the exception. However, state ownership and control are unlikely to be obstacles to accessing arbitration under investment treaties that leave open the form of ownership of the investors covered by the treaty (e.g., most Russian and Chinese bilateral investment treaties (BITs)).

According to the 2016 judgment of the Paris Court of Appeals in *Ukraine v. Tatneft*, treaties that do not explicitly include the requirement of private ownership in the definition of investors

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cannot be limited in scope to “private investors.” According to the 2017 *China Heilongjiang v. Mongolia* arbitral award, “the fact that the Chinese State directly or indirectly owns . . . China Heilongjiang has no relevance for the purpose of [China Heilongjiang’s] qualification as [an] ‘economic enti[y],’” and thus qualifies as an “investor” within the meaning of the China-Mongolia investment treaty. If the absence of an explicit reference to state ownership and control is interpreted to exclude SOEs from the scope of investment treaties, a very significant share of China’s and Russia’s foreign investments would be denied the benefit of arbitration.

Second, access to arbitration of geopolitical projects depends on their legal qualification as “investments,” and in particular whether the applicable treaty is limited in scope to purely commercial investment activities. Most investment treaties adopt a broad definition of investment as “every kind of asset, owned or controlled by an Investor.” Certain investment treaties expressly refer to “economic activities” or “business enterprises” in the definition of investment. Arbitral tribunals have taken diverging approaches to

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61 See Cour d’Appel [CA] [regional court of appeal] Paris, civ., Nov. 29, 2016, 14/17964, ¶ 514 (Fr.) (confirming that the entity requesting the arbitration benefited from the protection of the bilateral investment treaty as it had to be considered to be a foreign investor and not be assimilated with the contracting state); id. at ¶ 525 (holding that for the Court, neither the Vienna Convention on the Law of Treaties nor any principle of interpretation allows a distinction where the bilateral investment treaty does not distinguish. Yet, the latter does not refer to any “private” investor.). See also Convention on the Settlement of Investment Disputes Between States and Nationals of Other States Preamble (Oct. 14, 1966), https://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf [https://perma.cc/6KSJ-FMPV] (referring to the “role of private international investment” for international economic cooperation, without limiting the scope of the Convention to private investors) (emphasis added).


63 See Annacker, supra note 58, at 539–40 (discussing investment treaties that fail to expressly protect SOEs investing abroad).

64 *JESWALD SALACUSE, THE LAW OF INVESTMENT TREATIES* 195 (Sir Frank Berman KCMG QC ed., 2d ed. 2015).

the interpretation of “investment” when investment activities are linked to the home state’s foreign policy.

On the one hand, some arbitral tribunals have been reluctant to engage in an assessment of the motivation underlying foreign investments. According to the 2006 arbitral decision in *Saluka v. Czech Republic,* “[e]ven if it were possible to know an investor’s true motivation in making its investment, nothing . . . makes the investor’s motivation part of the definition of an ‘investment.’”66 In the 2003 *CSOB v. Slovakia* award, the tribunal ruled that “in determining whether [the state-owned entity], in discharging these functions, exercised governmental functions, the focus must be on the nature of these activities and not their purpose.”67 The claimant in this case was found to act on behalf of the state and to promote governmental policies and purposes. Nevertheless, the tribunal found that the activities themselves (i.e., banking) were essentially economic rather than governmental in nature, and, on this basis, the tribunal accepted jurisdiction.68

On the other hand, in *China Heilongjiang v. Mongolia,* the arbitral tribunal readily examined whether the claimants acted as “quasi-instrumentalities of the Chinese government.”69 In particular, the

66 *Saluka Investments BV v. Czech Republic,* 18 World Trade & Arbitration Materials 169 (Perm. Ct. Arb. 2006); *see also* Annacker, *supra* note 58, at 543–44 (arguing, in the same vein, that investment treaties do not “exclude investments because the assets invested are . . . invested in furtherance of State policies or purposes”).

67 *Ceskoslovenska Obchodni Banka v. Slovakia,* ICSID Case No. ARB/97/4, Decision on Objections to Jurisdiction, ¶ 20 (May 24, 1999). *See also* CDC Group PLC v. Republic of the Seychelles, ICSID Case No. ARB/02/14, Award, ¶ 17 (Dec. 17, 2003) (acknowledging that the “CDC’s activities are commercial in substance and nature.”). It must be noted that both decisions were made on the basis of the ICSID Convention that, according to the so-called “Broches test” does not extend arbitration to foreign investors that are “acting as an agent for the government or [are] discharging an essentially governmental function.” Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, *supra* note 61.

68 For criticism of these decisions, *see* FELDMAN, *supra* note 57, at 24 (critiquing the decisions in the cases involving CSOB and CDC Group, respectively); BLYSHAK, *supra* note 9, at 30–32 (arguing against unconditional acceptance of the “nature” test applied in CSOB).

69 *Beijing Shougang Mining Inv. Co. Ltd., et al. v. Mongolia,* *supra* note 57, at ¶ 418.
tribunal assessed whether the Chinese state-owned enterprises acted under the Chinese government’s “express instruction to invest abroad in order to serve China’s foreign policy goals,” and concluded that they did not. 70 Similarly, in the 2017 Beijing Urban Construction Group v. Yemen award, the tribunal assessed whether the Chinese state-owned enterprise functioned as an agent of the state. 71 In that case, the tribunal focused on the functions of the enterprise “in the particular instance” of its investment activity, and again ruled that the SOE did not make the investment concerned as a state agent. 72

By focusing on the commercial nature (as opposed to the purpose) of investments, the former interpretative approach (endorsed by the Saluka and CSOB tribunals) opens arbitration to investors that pursue foreign policy objectives. Geopolitical investments—as part of a State’s infrastructure diplomacy—are generally economic in nature. In the energy sector, for instance, they are made in connection with the economic activities of energy production, transportation, or supply. Moreover, these investments are generally long-term, involve operational risks, and contribute to the economic development of the host state. 73 The same conclusion applies to strategic investments that have limited prospects of future profitability (e.g., Russian investments in power plants in Central Asia). Some investment treaties include the “expectation of gain or profit” in the definition of investment. 74 Even in this case, international investment law does not condition access to arbitration to a market-economy test or a rational-investor test. 75 As

70 Id.
71 Beijing Urban Construction Group v. Yemen, Award, ICSID Case No. ARB/14/30, ¶ 42 (May 31, 2017).
72 Id.
75 In contrast, at the pre-establishment stage, governments (e.g., in the USA and Australia) look at the motivation of the prospective investors. The Australian
highlighted by the Allard v. Barbados case, tribunals can accept that “expectations of an eventual profit were honestly held by [the investor] . . . notwithstanding that . . . factors of profit were considered secondary and in the background to his principal motivations of . . . public purposes.”

However, following the latter purpose-based interpretative approach (endorsed by the China Heilongjiang and Beijing Urban Construction Group tribunals), an arbitral tribunal can in principle refuse jurisdiction if there is evidence that the foreign investment was made in the pursuit of the home state’s strategic interest, based on express instructions by the home state government. According to geopolitical theory and as highlighted by Russia’s energy investments in Central Asia, geopolitical investments can be made on the basis of express government orders to realize these projects as part of the country’s foreign policy (infrastructure diplomacy).

However, finding conclusive evidence of the strategic rationale of an investment is a most delicate task. As examined above, the

Government considers “if the investment is commercial in nature or if the investor may be pursuing broader political or strategic objectives that may be contrary to Australia’s national interest.” Treasury of the Commonwealth of Australia, Australia’s Foreign Investment Policy 10 (2016), https://firb.gov.au/files/2015/09/Australias-Foreign-Investment-Policy-2016-2017.pdf [https://perma.cc/NAV5-GND5]. The Committee on Foreign Investment in the USA examines whether investments have been “based solely on commercial grounds”, taking into account the degree of disclosure by the investor of the objectives of its investments. Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States, 73 Fed. Reg 74,567, 74,571 (Dec. 8, 2008), https://www.treasury.gov/resource-center/international/foreign-investment/Documents/CFIUSGuidance.pdf [https://perma.cc/WER5-6T5A].


78 For instance, concomitance between the making of a certain foreign investment and certain geopolitical developments could serve as evidence of the geopolitical purpose of a foreign investment. See, e.g., Caratube International Oil Company LLP v. Republic of Kaz., ICSID Case No. ARB/13/13, Award, ¶ 936 (Sept.
objectives of geopolitical investments are often masked and mixed with commercial considerations. With “hybrid companies masquerading as commercial actors, but actually controlled by states and acting with strategic consequences,” the geopolitical purpose of investments is difficult to determine based on objective factors.

In conclusion, a host state government’s perception that a certain investment poses a risk to national security is difficult to integrate into the tribunal’s analysis on jurisdiction. Rejecting the purpose-based approach to the assessment of investments is both logical and practical. By focusing on the economic nature of investments, arbitration tribunals avoid the delicate task of discovering the real motivation underlying foreign investments in strategic sectors. On this basis, investment arbitration can provide the forum for the resolution of disputes that indirectly involve the home state as claimant and that concern heavily politicized issues of potential high strategic importance for both states involved. However, as will be seen in the following section, geopolitical arguments relating to governments’ perceptions of risk are relevant for the application of substantive standards of protection.

4. MERITS: STATES’ RIGHT TO REGULATE GEOPOLITICAL RISK

The debate in the investment law literature on the sovereign right to regulate has, to a large extent, centered on the internalization of environmental externalities. A closely related question is

79 See Section II.A, infra.
80 Clinton, supra note 37.
81 Blyshak, supra note 9, at 29; Ji Li, State-Owned Enterprises in the Current Regime of Investor-State Arbitration, in The Role of the State in Investor-State Arbitration 380, 401 (Shaheez Lalani & Rodrigo Polanco eds., 2015).
82 For criticism, see Blyshak, supra note 9, at 39 (discussing potential complications with investment arbitration involving a “government agent”); Feldman, supra note 58 (discussing issues of standing for SOEs under the ICSID).
83 See, e.g., Kyla Tienhaara, The Expropriation of Environmental Governance: Protecting Foreign Investors at the Expense of Public Policy (2009) (discussing the relationship between investment protection and environmental protection); Jorge Viñuales, Foreign Investment and the
whether, in the context of increasing concerns regarding the role of SOEs as geopolitical actors, investment arbitration recognizes the host states’ right to internalize the security externalities of existing investments in strategic assets (e.g., new operational restrictions, mandatory partnership with a national investor, and even forced disinvestment). Can the host states’ perception of geopolitical risk justify security measures under investment arbitration—a mechanism that aims to depoliticize investor-state disputes on the basis of “objective enquiry”84 and “objective legal criteria”?85

4.1. Non-discrimination of Non-allied Foreign SOEs and Due Process

The admission of foreign investments in strategic sectors following a national security review does not on its own constitute a commitment by the state to refrain from adopting more stringent security requirements in the future.86 In some cases, national law can even explicitly foresee the possibility to reopen security reviews.
for existing investments and adopt additional security requirements if this is necessary to address new security risks.\footnote{87} The dynamic nature of geopolitics can help justify the need for regulatory changes to the certification of an existing investment. Changes in alliances and the deterioration of relations between the host state and the home state affect the host state’s perception of security risk of investments by SOEs, thus requiring regulatory intervention in cases of foreign control over strategic assets.\footnote{88}

A key challenge to the justification of new security requirements is that measures taken in the context of geopolitical tensions target SOEs from non-allied states and treat them differently from investors from allied states and national investors.\footnote{89} These measures are often “directed specifically against a certain investor by reason of his, her or its nationality,” and thus raise questions of compatibility with the investment protection standards of national treatment, most favored nation, expropriation, and fair and equitable treatment.\footnote{90}

In the EU energy sector, for instance, Russian investments are seen with increasing suspicion in the context of deteriorating EU-

\footnote{87} For instance, the “Gazprom clause” recognizes the “right of Member States to exercise . . . national legal controls to protect legitimate public security interests” and establishes the right of the EU Commission to request national authorities to re-open a certification procedure. Concerning Common Rules for the Internal Market in Natural Gas Art. 11, July 13, 2009, Directive 2009/73/EC, O.J. L211/94.

\footnote{88} See Section II.B, \textit{infra}.

\footnote{89} Nationality-based difference in treatment also affects security reviews at the pre-establishment stage. In Australia, for instance, the Foreign Investment Review Board in 2016 rejected a bid by the Chinese state-owned company State Grid for the network company Ausgrid on the basis of security concerns in the absence of a partnership with a local investor, while North American bidders were allegedly told that they would not be bound by the same security requirements. See Jamie Freed, \textit{Australia Courts U.S., Canada After Rejecting Chinese Bids for Ausgrid}, REUTERS (Sept. 13, 2016), \url{http://www.reuters.com/article/us-australia-privatisation-ausgrid-idUSKCN11K07E} [\url{https://perma.cc/QH4J-7SLC}].

\footnote{90} Noble Ventures, Inc. v. Romania, ICSID Case ARB/01/11, Award, ¶ 180 (Oct. 12, 2005). See also \textsc{Rudolf Dolzer \& Christoph Schreuer}, \textit{Principles of International Investment Law} 200–01 (2012) (discussing various considerations in defining differentiation); Andrea Bjorklund, \textit{National Treatment, in Standards of Investment Protection} 29, 37 (August Reinisch ed., 2008) (claiming that NAFTA Chapter 11 awards are leading jurisprudence in the area of national treatment disputes, but that tribunals are nevertheless not uniform in how they decide national treatment cases).
Russian relations.\textsuperscript{91} According to the 2014 Energy Security Strategy, the EU aims to reduce its dependency on Russian gas, which currently amounts to more than one third of EU natural gas imports.\textsuperscript{92} However, Norwegian gas imports and energy investments are not a cause of concern, despite the fact that Norwegian gas amounts to more than 30 percent of EU imports.\textsuperscript{93} Although \textit{de jure} EU law remains neutral on the energy security requirements of non-EU companies, there are clear risks of \textit{de facto} discrimination in the application of the Gazprom Clause, and EU energy and competition law more generally.\textsuperscript{94} In the US, a Chinese investor in wind energy production was forced in 2012 to divest its investment in a wind energy farm based on security concerns relating to its location in proximity of a military basis, while other foreign energy investors in the same zone could allegedly continue to operate their installations.\textsuperscript{95}

Geopolitical analysis can help host states demonstrate that foreign investors that are perceived to present a security risk are not “in like circumstances” with domestic or other foreign investors in the same sector or business because of the different geopolitical circumstances that characterize these investments.\textsuperscript{96} By analyzing the strategic use (infrastructure diplomacy) that certain states make of foreign investments in strategic assets,\textsuperscript{97} the economic statecraft and geopolitical theories explain how investments by the SOE of a

\textsuperscript{91} See Section II.B, infra.

\textsuperscript{92} European Commission, supra note 48, at 1.


\textsuperscript{94} See Section II.B, infra. See also Cottier, et al., supra note 51, at 12 (discussing the treatment of foreign service suppliers under the Gazprom Clause); Goldthau, supra note 13, at 14 (discussing problems associated with unequal bargaining power in gas pipeline infrastructure).

\textsuperscript{95} Ralls Corp. v. Comm. on Foreign Inv. in U.S., 758 F.3d 296 (D.C. Cir. 2014).

\textsuperscript{96} Arbitral practice generally accepts that “only foreign and domestic investments that raise similar public policy concerns should be compared.” Nicholas DiMascio & Joost Pauwelyn, Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?, 102 Am. J. Int’l L. 48, 72 (2008).

\textsuperscript{97} See Section II.A, infra.
non-allied state can be a “legitimate concern” for the host state.\textsuperscript{98} 
Moreover, the theory on the dynamic nature of geopolitics\textsuperscript{99} helps explain how, following the deterioration of bilateral relations between the host and home states, mitigating the security risks associated with a strategic investment can be “a legitimate public policy objective.”\textsuperscript{100}

According to the economic statecraft and geopolitical theories, it is a government’s perception of risk – and not necessarily a fully rational and objective assessment of the geopolitical reality – that can drive host state to intervene with investments of a specific SOE in a strategic asset.\textsuperscript{101} Despite the objectivity of the arbitration process, investment tribunals generally accept that a host state’s perceived need of a certain policy can provide a legitimate reason for regulatory intervention with investments.\textsuperscript{102} “Some measure of inefficiency, a degree of trial and error, [and] a modicum of human imperfection” are permissible.\textsuperscript{103}

In the context of geopolitical tensions between the home and the host state, the risk of arbitrary interference with investments from

\textsuperscript{98} See, e.g., Genin v. Est., ICSID Case No. ARB/99/2, Award, ¶¶ 362, 370 (June 25, 2001) (discussing the importance of “legitimate concerns” and “legitimate public purpose” for the assessment of state measures under the non-discrimination and fair and equitable treatment standards). See also Kenneth Vandevelde, \textit{A Unified Theory of Fair and Equitable Treatment}, 43 N.Y.U. J. INT’L L. & POL. 43, 54 (2010) (explaining that reasonableness, one of the principles in determining fair and equitable treatment standards, requires the conduct to be reasonably related to a legitimate public policy objective).

\textsuperscript{99} See Section II.B, \textit{infra}.

\textsuperscript{100} Vandevelde, \textit{A Unified Theory}, supra note 98, at 54. See also Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. Mex., ICSID Case No. ARB/(AF)/04/5, Award, ¶¶ 110–84 (Nov. 21, 2007); Corn Products Int’l, Inc. v. Mex., ICSID Case No. ARB/(AF)/04/1, Decision on Responsibility, ¶¶ 144–91 (Jan. 15, 2008) (both discussed in Paparinskis, supra note 11, at 271 as examples of how “the broader controversies between the home and host States can be brought back into the arbitral process.”).

\textsuperscript{101} See Section II.B, \textit{infra}.

\textsuperscript{102} See, e.g., GAMI Investments, Inc. v. Mex., UNCITRAL, ¶ 114 (Nov. 15, 2004) (finding that Mexico’s perceived legitimate goal in favor of public policy, though misguided, was not discriminatory); see also Martins Paparinskis, \textit{Good Faith and Fair and Equitable Treatment in International Investment Law}, in \textit{GOOD FAITH AND INTERNATIONAL ECONOMIC LAW} 143 (Andrew D. Mitchell et al. eds., 2015) (discussing the role of good faith in international investments).

\textsuperscript{103} See Eastern Sugar B.V. v. Czech, SCC Case No.088/2004, Partial Award, ¶ 272 (Mar. 27, 2007) (holding that “some measure of inefficiency, a degree of trial and error, [and] a modicum of human imperfection” are permissible).
the home state is considerable. This risk is particularly acute for SOEs because of their close link with, and thus perceived influence on, the home state’s government. In principle, international investment law protects foreign investors against politically motivated measures.\textsuperscript{104} In \textit{Ampal-American Israel Corp. v. Egypt}, a 2017 decision concerning state interference with a gas pipeline investment in the context of geopolitical tensions between the importing state (Israel) and the exporting state (Egypt), the tribunal accepted to take into account the geopolitical context of the dispute.\textsuperscript{105} The tribunal ruled on this basis that the termination of the natural gas export agreement (the economic foundation of the investment) constituted a disproportionate act and thus an unlawful expropriation because Egypt “terminated the GSPA [export agreement] at a time when many in Egypt voiced strong opposition to the supply of gas to Israel.”\textsuperscript{106}

Similarly, according to \textit{Cargill v. Mexico}, “a measure . . . designed to put pressure on the [home state’s government] will focus on those who are likely to be able to influence the [home state’s] government and, in this, there is no necessary relationship with economic circumstances. In other words, (. . .) there is no link here between the alleged difference—a difference in economic circumstances—and the rationale and objective of the measure in question.”\textsuperscript{107} According to \textit{Waste Management v. Mexico}, there can be no doubt that “a deliberate conspiracy” against the foreign investment would constitute a breach of a basic obligation of treatment.\textsuperscript{108} According to \textit{Tokios Tokeles v. Ukraine}, a “deliberate campaign to punish [a

\textsuperscript{104} See, e.g., Eureko B.V. v. Pol., UNCITRAL Arb., Partial Award, ¶ 46 (Aug. 19, 2005) (noting that the State Treasury Minister admitted his attempt to void an investment agreement was politically motivated); Azurix Corp. v. Arg., ICSID Case No. ARB/01/12, Award, ¶¶ 375, 378, 426 (July 14, 2006) (finding that “politicalization . . . is an element in the . . . determination that the fair and equitable standard has been breached”); Biwater Gauff, Ltd. v. Tanz., ICSID Case No. ARB/05/22, Award, ¶¶ 500, 698 (July 18, 2008) (finding political motives behind termination of a contract “were inconsistent with the Republic’s obligations”).

\textsuperscript{105} Ampal-American Israel Corp. v. Egypt, ICSID Case ARB/12/11, Decision on Liability and Heads of Loss, ¶ 344 (Feb. 21, 2017).

\textsuperscript{106} \textit{Id.}

\textsuperscript{107} Cargill, Inc. v. Mexico, ICSID Case ARB(AF)/05/2, Award, ¶¶ 209, 220 (Sept. 18, 2009).

\textsuperscript{108} Waste Management, Inc. v. Mexico, ICSID Case ARB(AF)/00/3, Award, ¶ 138 (Apr. 30, 2004).
foreign investor for political reasons] must surely be the clearest infringement one could find of the provisions and aims of the Treaty.”

Invoking the policy objective of mitigating the security risks associated with strategic investments is thus not enough to justify all measures taken by a state in the name of this policy. The security measure must be “taken because of” the perceived security risks characterizing the strategic investment, and not to achieve an abstract objective, such as retaliating against the SOE to punish or seek to influence the home state’s government.

By de-codifying the strategic behavior of states, geopolitical analysis can help distinguish between reasonable and arbitrary interference with strategic investments. On the one hand, geopolitical analysis highlights that, in the context of interstate tensions, the host state can have genuine concerns that the SOE from a non-allied state can make use of its control over a strategic asset, such as energy, to undermine the host state’s national security (e.g., by interrupting energy supply). On this basis, regulatory

109 Dissenting Opinion of Daniel M. Price, in Tokios Tokeles v. Ukraine, ICSID Case No. ARB/02/18, Award (July 26, 2007), citing Tokios Tokeles v. Ukraine, ICSID Case No. ARB/02/18, Award, ¶ 123.

110 AES Summit Generation Ltd. v. Hungary, ICSID ARB/07/22, Award, ¶ 10.3.9 (Sept. 23, 2010). See also Jürgen Kurtz, Balancing Investor Protection and Regulatory Freedom in International Investment Law: The Necessary, Complex and Vital Search for State Purpose, in YEARBOOK ON INTERNATIONAL INVESTMENT LAW & POLICY 2013-2014 251, 279 (Andrea Bjorklund ed., 2015) (arguing that the tribunal in GAMI v. Mexico failed to draw a distinction between Mexico’s general policy goals and the specific “exercise of discretion when implementing that goal”).

111 Cargill, supra note 107, at ¶ 204.

112 Vandevelde, supra note 98, at 97; Técnicas Medioambientales Tecmed S.A. v. Mexico, ICSID Case ARB(AF)/00/2, Award, ¶ 163 (May 29, 2003).

113 For instance, the WTO Panel in European Union and its Member States – Certain Measures Relating to the Energy Sector (WT/DS476/R), 10 August 2018, ¶ 7.1202, ruled that “foreign control of TSOs [Transmission System Operators] poses a genuine and sufficiently serious threat to a fundamental interest of the EU society, namely its security of energy supply.” The Panel came to this conclusion by accepting the argument that “there is a real and true possibility, rather than a merely hypothetical one, of foreign governments requiring or inducing foreign controlled TSOs to undermine the European Union’s security of energy supply” (¶ 7.1194) and considering that “[s]ince natural gas is transported by TSOs through infrastructure, which is fixed and, at any given time, of finite quantity, it can reasonably be inferred that there will be a significant impact on the supply of natural gas, and hence energy, if a foreign government requires or induces even a
interference with the SOE’s investment can be justified by the host state’s perception that the specific security risk linked to a strategic asset can materialize following the deterioration of bilateral relations with a previously allied home state. On the other hand, geopolitical analysis highlights how, in the context of interstate disputes, the host state can be tempted to interfere with SOEs to influence or retaliate against the home state. By protecting foreign investments against regulatory measures that are motivated by political considerations, investment arbitration provides a forum for the depoliticization of investment disputes. Such a forum avoids SOEs from becoming the victims of geopolitical tensions between the home and host states.

The transparency of the host state’s relation with the foreign investor can be a decisive factor in determining whether the host state acted in good faith and with respect of due process. In cases concerning the security risks of geopolitical investments, the issue of transparency is delicate because of the sensitivity of the information related to national security. However, there is no reason why investors in strategic assets would not have the right to benefit from basic procedural protections such as the right to be informed of the security action against its investment, to be given access to unclassified evidence on which the government relied to make its decision on the need for additional security measures, and to be afforded an opportunity to rebut that evidence. According to Saluka Investments v. Czech Republic, the failure of the host state to disclose the rationale underlying a discriminatory measure can

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114 Tecmed, supra note 112, at ¶ 154. See generally Maffeini v. Kingdom of Spain, ICSID Case No. ARB/97/7, Award, ¶ 83 (Nov. 13, 2000); MTD Equity v. Republic of Chile, ICSID Case No. ARB/01/7, Award, ¶ 163 (May 25, 2004); Champion Trading Co. v. Arab Republic of Egypt, ICSID Case No. ARB/02/9, Award, ¶ 164 (Oct. 27, 2006); Siemens A.G. v. Argentine Republic, ICSID Case No. ARB/02/8, Award, ¶ 84 (Feb. 6, 2007); PSEG Global, Inc. v. Republic of Turkey, ICSID Case No. ARB/02/5, Award, ¶¶ 173–74 (Jan. 19, 2007) (discussing the principle of transparency under international investment law). But see United Mexican States v. Metalclad Corporation, BCSC 664, ¶¶ 68-70 (2001) (explaining the insignificance of transparency problems in determining a certain international investment issue).

115 Ralls Corporation v. CFIUS, supra note 95.
amount to a violation of the fair and equitable treatment standard.\textsuperscript{116} Moreover, arbitral tribunals can assess the extent to which the host state informed the investor of the preconditions for an acceptable solution to the perceived risk,\textsuperscript{117} such as entering into a partnership with an investor from the host state or an allied State.\textsuperscript{118}

Given the stress on objectivity that is supposed to govern the arbitration process, the relevance of the host state’s perception of risk to justify interference with investors is not self-evident. Depending on the measure of deference that arbitral tribunals provide to states, the application of objective legal criteria to the assessment of security measures can impose important limitations on the implementation of security policies. For instance, in AAPL v. Sri Lanka,\textsuperscript{119} the tribunal examined the destruction by government forces of an investment, a farm, that was allegedly used as an operational center for separatist activities during the Tamil insurgency against the government.\textsuperscript{120} Applying an objective standard of vigilance of the state,\textsuperscript{121} the majority of the tribunal ruled that the government should have tried peaceful communication before undertaking military action against the investment.\textsuperscript{122} The majority’s decision generated criticism for second-guessing the

\textsuperscript{116} Saluka Investments BV v. Czech Republic, supra note 66, at ¶ 407. See also MTD Equity, supra note 114, at ¶ 163 (highlighting the inconsistency between two arms of government in implementing the legal framework to regulate the foreign investment); Siemens, supra note 114, at ¶ 84; Tecmed, supra note 112, at ¶ 215 (discussing the disclosure by states of crucial information on the regulation of a foreign investment).

\textsuperscript{117} Saluka, supra note 66, at ¶¶ 420–25.


\textsuperscript{119} Asian Agricultural Products Ltd. (AAPL) v. Sri Lanka, Award, ICSID Case ARB/87/3 (June 27, 1990).


\textsuperscript{121} AAPL, supra note 119, at ¶ 77.

\textsuperscript{122} Id. at ¶ 84.
modalities and timing of a “strategic and highly sensitive security operation to regain its sovereign control of the area of insurgency.”\textsuperscript{123} By refusing to recognize that the government was under a compelling sovereign duty to undertake action and by rejecting its strategic decisions, the majority can be criticized for unduly interfering with the exercise by the state of its sovereign powers.\textsuperscript{124} Indeed, in determining whether a certain state of affairs engages national security concerns, tribunals have good reasons to “afford a measure of deference to states, principally on the basis that states are best placed to determine whether the situation in their territory engages these concerns.”\textsuperscript{125}

In principle, the sovereign right of states to regulate and protect critical infrastructure against security threats from foreign actors must be respected. Provided that the host state can demonstrate how investors of a certain origin can use control over a certain asset to harm national security, such as interrupt energy supply, a certain level of deference is due in the assessment of security measures. Geopolitical analysis can provide a strong rationale for state intervention by helping the host state to substantiate its perception of risk relating to foreign ownership over a particular asset and the home state’s potential strategic ambitions with that asset.

\textsuperscript{123} Samuel Asante, Dissenting Opinion in AAPL, supra note 119.

\textsuperscript{124} See Giuditta Cordero Moss, Full Protection and Security, in STANDARDS OF INVESTMENT PROTECTION 131, 140 (August Reinisch ed., 2008) (suggesting that the majority in AAPL applied the “due diligence” criterion in a controversial way); Vasciannie, supra note 120, at 353.

\textsuperscript{125} Caroline Henckels, Balancing Investment Protection and the Public Interest: The Role of the Standard of Review and the Importance of Deference in Investor-State Arbitration, 4 J. INT. DISP. SETTLEMENT 197, 207 (2013) (arguing that appropriately deferential approach to the standard of review from investment tribunals would achieve a more balanced relationship between the protection of foreign investment and the host state); see also Freya Baetens, Discrimination on the Basis of Nationality: Determining Likeness in Human Rights and Investment Law, in INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW 279, 313 (Stephan Schill ed., 2010) (suggesting that serious security concerns could justify discriminatory measures even when there was an intent to discriminate against the particular investor based on its nationality); GUS VAN HARTEN, SOVEREIGN CHOICES AND SOVEREIGN CONSTRAINTS: JUDICIAL RESTRAINT IN INVESTMENT TREATY ARBITRATION 89 (2013) (reviewing arbitral decisions and finding that there are very few indicators of restraint “based on the relative capacity of governments”).
4.2. The “Essential Security Interest” Exception

In a case where an arbitral tribunal refuses to recognize the government’s right to regulate geopolitical risk, a state can invoke the “essential interest” clause, if applicable under the relevant BIT. These clauses authorize states to derogate from their investment protection obligations if it is necessary to protect their essential interests.\textsuperscript{126} To qualify as an essential interest under international law, the risk that foreign investments represent for national security must meet the threshold set by investment tribunals.\textsuperscript{127}

Arbitral Tribunals accept that economic emergencies, and not just military security, can qualify as an essential security interest of the state.\textsuperscript{128} In LG&E v. Argentina, the Tribunal highlighted that economic problems can constitute an essential security interest, because “When a State’s economic foundation is under siege, the severity of the problem can equal that of any military invasion.”\textsuperscript{129} According to economic statecraft and geopolitical theories, the use of investments for strategic purposes is sometimes a preferred means of geopolitical combat to the exercise of military power.\textsuperscript{130}

Following the LG&E decision, the security implications of geopolitical investments can represent essential security interests, in case the risk for the economy is sufficiently severe, for example a blackout of the electricity system. The host state will have to

\textsuperscript{126} See William Burke-White & Andreas von Staden, Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties, 48 VA. J. INTL. L. 307, 349-354 (2008) (describing NPM clauses that allow states to take actions otherwise inconsistent with the treaty in certain situations, for example, the actions that are necessary for the protection of essential security); see also Caterine Gibson, Beyond Self-Judgement: Exceptions Clauses in US BITs, 38 FORDHAM INTL. L. J. 1 (2015) (analyzing and suggesting exceptions clauses in the BIT for US negotiators).

\textsuperscript{127} UNCTAD, supra note 6, 72–102.

\textsuperscript{128} Continental Casualty Company v. Argentina Republic, ICSID Case ARB/03/9, Award, ¶ 175 (Sept. 5, 2008); see also William J. Moon, Essential Security Interests in International Investment Agreements, 15 J. INTL. ECON. L. 481, 500 (2012) (arguing that essential security interests are not triggered unless a host state's national security interests are at stake.).

\textsuperscript{129} LG&E Energy Corp. v. Argentina, ICSID Case ARB/02/1, Decision on Liability, ¶ 238 (Oct. 3, 2006).

\textsuperscript{130} Blackwill & Harris, supra note 4, at 1–18; see also Baldwin, supra note 1, at 9 (discussing the implications of the rise in using geoeconomic policies in addition or in place of traditional military power).
demonstrate how the SOE from a non-allied country can use its control over a strategic asset to threaten public security.

Threats to national security and the necessity to act to avoid these threats must be established on the basis of objective criteria, leaving little room for “measures of discretion,” unless the treaty explicitly recognizes the right of the state to apply measures that are non-compliant with the treaty in cases where compliance would be harmful to the State’s essential interests. By allowing for “the subjective evaluation of the State claiming the derogation,” the so-called “self-judging” clauses provide a strong basis for the recognition of the states’ perception of security risk relating to the control of strategic assets by certain investors. The role of arbitral tribunals is limited to a good faith review of the contested state measure, in particular of whether there is a rational basis for the state’s invocation of the applicable essential security clause. Geopolitical analysis can help states to substantiate their concerns regarding the control by certain states over strategic assets and justify the connection between this perceived threat to national security and the measures taken.


133 Id. at 68.

134 Burke-White & von Staden, supra note 126, at 379.
5. CONCLUSION

The economic statecraft and geopolitical theories uncover dimensions to investment making and protection that are most relevant to investment law, but which cannot be fully understood solely on a legal analysis of the investments. Certain states make use of foreign investments to achieve geopolitical objectives (e.g., control over resources and exercise of influence in regions of strategic importance) – a practice that is most developed in the energy sector.

The geopolitical dimension of investments in strategic assets raises security concerns for host states. So far, the investment law literature has mostly focused on the role that national security reviews play at the pre-establishment stage to address the threat that foreign investments can represent for national interests. The economic statecraft and geopolitical theories highlight that threats to national security can occur after investments have been approved and implemented. Although the geopolitical reality, such as the strategic importance of resources and regions, is characterized by relative stability, the states’ perception of risk and subsequent strategic reaction can undergo rapid changes. As highlighted in the context of the deterioration of EU-Russian relationship, the control of strategic assets by an SOE holding the nationality of a country that is perceived as hostile can be seen as an unacceptable risk to national security that requires regulatory intervention.

Despite the objective to “remove investment disputes from the intergovernmental political sphere,” investment arbitration, with the help of geopolitical analysis, can discipline the regulatory responses to the perceived security risks of strategic investments. Following existing arbitral practice, SOEs are likely to benefit from access to investment arbitration, including such cases where the geopolitical dimension of their investments is obvious. The focus of the tribunals on the commercial nature, rather than on the purpose, of the investment activity to accept jurisdiction opens the door to the arbitration of geopolitical and thus state-to-state disputes.

However, the alternative of blocking access to arbitration based on geopolitical considerations is unrealistic because it involves second-guessing the motivation of investors in projects that often involve a complex mix of commercial and strategic objectives.

Economic statecraft and geopolitical theories are of limited relevance for the host states’ defense on jurisdiction, but they can provide support to justify regulatory interference with strategic investments under the substantive standards of protection. From the host state’s perspective, geopolitical arguments can be used as objective indicators to justify regulatory intervention with investors of a certain origin, and not with others. Moreover, the theory of geopolitical change helps to explain how the deterioration of interstate relations and changes to strategic alliances create new security risks that, in certain circumstances, can require interfering with the investors’ expectations of regulatory stability. These objective legal arguments are particularly important for states that are bound by investment treaties that do not contain a self-judging essential security exception clause. The fact that security interests are concerned supports a higher level of deference for the national policy-maker.136 Assessing the availability of alternative, and less harmful, security measures can impose an excessively high degree of scrutiny on the exercise by the host state of its sovereign regulatory powers.

From the perspective of investors, economic statecraft and geopolitical theories contribute to disciplining state interference by rationalizing the criteria on the basis of which security risks and state measures can be evaluated. A certain degree of subjectivity in the definition of a country’s national interests, and its foreign policy actions, is unavoidable. External policy measures, to a large extent, depend on the states’ perception of the geopolitical reality. However, if security arguments remain subjective, states could be “free to propose whatever explanation one deems fit”137 to justify a strategic reorientation of their geopolitical objectives, such as its external energy relations and, on this basis, to interfere with existing foreign investments in strategic assets. Subjective arguments relating to the perceived threat that specific foreign investments pose to a country’s national security interests potentially open the door to a very broad basis for state interference with these investments. The use of geopolitical analysis under investment

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136 See generally Henckels, supra note 125.
137 Guzzini, supra note 14, at 39.
arbitration, for example on the security risks associated to national dependence on certain exporters, the competition for resources, the strategic use by states of investments by SOEs and the consequences of geopolitical change, provide more objective indicators to substantiate the risk that investments represent, or are perceived to represent, for national security.