

## ECONOMIC STATECRAFT AND INVESTMENT ARBITRATION

ANATOLE BOUTE\*

### 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.

---

\* Associate Professor, Faculty of Law, The Chinese University of Hong Kong (email: [anatole.boute@cuhk.edu.hk](mailto:anatole.boute@cuhk.edu.hk)).

## TABLE OF CONTENTS

1. Introduction .....	385
2. A Geopolitical Perspective to Foreign Investment.....	388
2.1. <i>Economic Statecraft and Geopolitical Investments</i> .....	389
2.2. <i>Geopolitical Risk, Security Externalities, and Regulatory Changes</i> .....	394
3. Jurisdiction: Access of Geopolitical Investors to Investor-State Arbitration .....	398
4. Merits: States' Right to Regulate Geopolitical Risk.....	404
4.1. <i>Non-discrimination of Non-allied Foreign SOEs and Due Process</i> .....	405
4.2. <i>The "Essential Security Interest" Exception</i> .....	414
5. Conclusion.....	416

## 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)<sup>1</sup> and “geopolitics” (i.e., the study of interstate competition for territory, resources, and security).<sup>2</sup> 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.<sup>3</sup> This concern finds support in a growing body of literature on economic statecraft, according to which certain states use SOEs to achieve geopolitical objectives.<sup>4</sup> Foreign investments by SOEs can be made to secure control over resources, obtain political concessions, or exercise influence in zones of special interest.<sup>5</sup> To protect national security, host states can block the

---

<sup>1</sup> 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).

<sup>2</sup> See, e.g., COLIN FLINT, *INTRODUCTION TO GEOPOLITICS* 38–47 (2d ed. 2012); JAKUB GRYGIEL, *GREAT POWERS AND GEOPOLITICAL CHANGE* 39 (2006) (discussing how some states can increase power by controlling resources).

<sup>3</sup> 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).

<sup>4</sup> 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).

<sup>5</sup> 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).<sup>6</sup> 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.<sup>7</sup> 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.<sup>8</sup> 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

---

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

<sup>6</sup> See, e.g., Rodolphe Desbordes & Vincent Vicard, *Foreign Direct Investment and Bilateral Investment Treaties: An International Political Perspective*, 37 J. COMP. ECON. 372, 373 (2009) (“foreign firms may suffer from the retaliatory consequences of deteriorating diplomatic relations between their home and host countries”); UNCTAD, *The Protection of National Security in IIAs*, ON THE UNCTAD 1, at 30–32 (2009), [http://unctad.org/en/docs/diaeia20085\\_en.pdf](http://unctad.org/en/docs/diaeia20085_en.pdf) [<https://perma.cc/Z5JM-4FS6>] (noting that host countries can impose emergency measures or force disinvestment if foreign investment poses a threat to national security).

<sup>7</sup> See generally INTERNATIONAL WORKING GROUP OF SOVEREIGN WEALTH FUNDS, *Sovereign Wealth Fund: Generally Accepted Principles and Practices (GAPP) “Santiago Principles”* (Oct. 2008), [http://www.ifswf.org/sites/default/files/santiagoprinciples\\_0\\_0.pdf](http://www.ifswf.org/sites/default/files/santiagoprinciples_0_0.pdf) [<https://perma.cc/K3FQ-4TAG>]; OECD, *OECD Guidelines on Corporate Governance of State-Owned Enterprises* 49 (2015 ed.), <http://dx.doi.org/10.1787/9789264244160-en> [<https://perma.cc/LX9A-XYZY>]; Ines Willems, *Disciplines on State-Owned Enterprises in International Economic Law: Are We Moving in the Right Direction?*, 19 J. INT’L ECON. L. 657 (2016).

<sup>8</sup> See generally Julien Chaisse, *Demystifying Public Security Exception and Limitations on Capital Movement: Hard Law, Soft Law and Sovereign Investments in the EU Internal Market*, 37 U. PA. J. INT’L L. 583 (2015).

investment arbitration.<sup>9</sup> 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"<sup>10</sup> and remove the home state from the arbitration process.<sup>11</sup>

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,<sup>12</sup> 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<sup>13</sup> 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.

---

<sup>9</sup> See Paul Blyshak, *State-Owned Enterprises and International Investment Treaties: When Are State-Owned Entities and their Investments Protected*, 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).

<sup>10</sup> Separate Opinion of Andreas Lowenfeld, in *Corn Products International, Inc. v United Mexican States*, ICSID Case No. ARB(AF)/04/1, concur in Parts I–VII of the Awards, ¶ 1 (2008). See also Aron Broches, *The Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, RECUEIL DES COURS 331 (1972) (noting impacts of SOEs on states).

<sup>11</sup> 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).

<sup>12</sup> See, e.g., James E. Mendenhall, *Assessing Security Risks Posed by State-Owned Enterprises in the Context of International Investment Agreements*, 31 ICSID REV. 36 (2016) (analyzing the extent to which investments by SOEs present national security risks to the host state).

<sup>13</sup> But see Andreas Goldthau, *Assessing Nord Stream 2: Regulation, Geopolitics and Energy Security in the EU, Central Eastern Europe and the UK*, *European Centre for Energy and Resource Security Strategy Paper*, 19 (2016), <https://www.kcl.ac.uk/sspp/departments/warstudies/research/groups/eucers/pubs/strategy-paper-10.pdf> [<https://perma.cc/KF4J-5J2Z>] (analyzing the geopolitical, regulatory, and energy security aspects as in the context of Nord Stream 2).

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."<sup>14</sup> 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.<sup>15</sup>

### 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.<sup>16</sup> "Infrastructure diplomacy" replaces or complements "gunboat diplomacy" as an instrument of geopolitical influence.<sup>17</sup>

Although the notion of geopolitics is the subject of controversy,<sup>18</sup> the literature generally agrees that, within its broad meaning,

---

<sup>14</sup> STEFANO GUZZINI, THE RETURN OF GEOPOLITICS IN EUROPE? SOCIAL MECHANISMS AND FOREIGN POLICY IDENTITY CRISES 40–43 (Stefano Guzzini ed., 2013).

<sup>15</sup> See Martin Walker, *Russia v. Europe: The Energy Wars*, 24 WORLD POL'Y J. 1 (2007) (describing Russia's use of its oil wealth as a geopolitical asset to subdue former Soviet states).

<sup>16</sup> See NORRIS, *supra* note 4, at 3 ("Economic statecraft can be broadly understood as state manipulation of international economic activities for strategic purposes."); BALDWIN, *supra* note 1, at 9 (describing statecraft as instruments used by policy makers to push others to do what they would not otherwise do); BLACKWILL & HARRIS, *supra* note 4, at 20 (stating that economic instruments are used to produce beneficial geopolitical results); Mikael Mattlin & Mikael Wigell, *Geoeconomics in the Context of Restive Regional Powers*, 14 ASIA EUR. J. 125 (2016) (analyzing how major regional powers leverage economic power in international relations).

<sup>17</sup> MILLER, *supra* note 4, at 13.

<sup>18</sup> See, e.g., Øyvind Østerud, *The Uses and Abuses of Geopolitics*, 25 J. PEACE RES. 191 (1988) (describing variations in the use of term geopolitics within the study of international relations); Christopher Fettweis, *Revisiting Mackinder and Angell: The Obsolescence of Great Power Geopolitics*, 22 COMP. STRATEGY 109 (2003) (arguing that

geopolitics concerns the interaction between geographical attributes (spatial location, size, topography, borders, climate, and distribution of resources) and international political power.<sup>19</sup> 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.”<sup>20</sup> Geopolitical analysis helps us to understand the practice of states competing for territory and resources, and defending their national security.<sup>21</sup> 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.<sup>22</sup>

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.<sup>23</sup> 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).

<sup>19</sup> 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).

<sup>20</sup> GRYGIEL, *supra* note 2, at 22.

<sup>21</sup> 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).

<sup>22</sup> 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 transnational 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).

<sup>23</sup> 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.<sup>24</sup> 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).<sup>25</sup> 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.<sup>26</sup> 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.<sup>27</sup> Third, states can use foreign energy investments to exercise broader geopolitical influence. Similarly to the subsidization of energy supply in exchange for geostrategic allegiance,<sup>28</sup> analysts explain Russian investments in the downstream energy infrastructure of post-Soviet countries (e.g.,

---

<sup>24</sup> See, e.g., THRASSY MARKETOS, CHINA'S ENERGY GEOPOLITICS: THE SHANGHAI COOPERATION ORGANIZATION AND CENTRAL ASIA 20 (2009) (describing China's decision to invest in the port of Gwadar in Pakistan in order to secure an alternative route to transport oil); Xiaolei Sun, et al., *China's Sovereign Wealth Fund Investments in Overseas Energy: The Energy Security Perspective*, 65 ENERGY POL. 1, 654-61 (2014) (describing China's use of its sovereign wealth fund to invest in foreign energy projects); Bo Kong & Kevin Gallagher, *The Globalization of Chinese Energy Companies: The Role of State Finance*, ON BOSTON ECONOMIC GOVERNANCE INITIATIVE 11-13 (2016), <http://www.bu.edu/pardeeschool/files/2016/06/Globalization.Final.pdf> [<https://perma.cc/FW2Q-CZAT>] (outlining Chinese government control over Chinese energy companies).

<sup>25</sup> See, e.g., HINRICH VOSS, 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).

<sup>26</sup> See Tatiana Mitrova, *The Geopolitics of Russian Natural Gas*, HARVARD UNIVERSITY BELFER CENTER & BAKER INSTITUTE CENTER FOR ENERGY STUDIES, at 15 (2014), [http://www.bakerinstitute.org/media/files/research\\_document/cdfea656/CES-pub-GeoGasRussiAx-022114.pdf](http://www.bakerinstitute.org/media/files/research_document/cdfea656/CES-pub-GeoGasRussiAx-022114.pdf) [<https://perma.cc/5EUS-9GEX>] (describing Russia's use of its gas resources to exercise influence over former Soviet states).

<sup>27</sup> See, e.g., Jekterina Grigorjeva & Marco Siddi, *Nord Stream 2: Opportunities and Dilemmas of a New Gas Supply Route for the EU*, JACQUES DELORS INSTITUTE (2016), [http://www.delorsinstitut.de/2015/wp-content/uploads/2016/05/20160510\\_Nord-Stream-2\\_Grigorjeva\\_Siddi-ONLIN.pdf](http://www.delorsinstitut.de/2015/wp-content/uploads/2016/05/20160510_Nord-Stream-2_Grigorjeva_Siddi-ONLIN.pdf) [<https://perma.cc/WF5N-N7KX>] (arguing that the Nord Stream 2 pipeline makes Europe more dependent on Russian gas).

<sup>28</sup> See Stacy Closson, *A Comparative Analysis on Energy Subsidies in Soviet and Russian Policy*, 44 COMMUNIST & POST-COMMUNIST STUD. 343 (2011) (describing Russia's use of hydrocarbon subsidies to influence former Soviet states).

power plants in Central Asia) are based on Russia's geopolitical interest in retaining these countries within its sphere of influence.<sup>29</sup> 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."<sup>30</sup> 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.<sup>31</sup>

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

---

<sup>29</sup> See, e.g., ALEXANDER COOLEY, GREAT GAMES, LOCAL RULES: THE NEW GREAT POWER CONTEST ON CENTRAL ASIA 67, 116-33 (2012); Natal'ia Skorolygina, *Rosneftgaz zaplatit za Kirgiziiu*, KOMMERSANT (Mar. 14, 2014), [www.kommersant.ru/doc/2428684](http://www.kommersant.ru/doc/2428684) [<https://perma.cc/M4KG-BNK2>] (detailing Russian government financing of a major Kyrgyz power plant); International Crisis Group, *Kyrgyzstan: A Hollow Regime Collapses* 5-6, <https://www.ciaonet.org/catalog/18752> [<https://perma.cc/E5AA-D4FS>] (arguing that Russian government's financial aid given to Kyrgyzstan for its energy crisis in 2009 was conditioned on Kyrgyz closure of U.S. airbase); LENA JONSON, TAJIKISTAN IN THE NEW CENTRAL ASIA: GEOPOLITICS GREAT POWER RIVALRY AND RADICAL ISLAM 77-78 (2006) (describing the competition between Russia and Iran to invest in Tajikistan's energy infrastructure).

<sup>30</sup> 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).

<sup>31</sup> 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); MILLER, *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.”<sup>32</sup> Others argue that Russian SOEs “serve the purposes of Russia’s foreign policy rather than commercial logic.”<sup>33</sup> The Nord Stream 2 project, for instance, is “not a commercial project only; it has huge political implications.”<sup>34</sup> Similarly, the rationale for outbound investments by Chinese SOEs is often defined based on a mix of geopolitical and commercial interests.<sup>35</sup> 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

---

<sup>32</sup> Rawi Abdelal, *The Profits of Power: Commerce and Realpolitik in Eurasia*, 20 REV. INT’L POL. ECON. 421, 438 (2013); see also Sanja Tepavcevic, *The Motives of Russian State-Owned Companies for Outward Foreign Direct Investment and its Impact on State-Company Cooperation*, 23 TRANSNAT’L CORP. 29, 53 (2015), [http://unctad.org/en/PublicationChapters/diaeia2015d1a2\\_en.pdf](http://unctad.org/en/PublicationChapters/diaeia2015d1a2_en.pdf) [<https://perma.cc/P8LT-U8TF>] (arguing that profits and business interests are the primary motivation of Russian SOE investments in foreign countries).

<sup>33</sup> Peeter Vahtra, *Expansion or Exodus? Russian TNCs Amidst the Global Economic Crisis*, PAN-EUROPEAN INSTITUTE 7 (2009), [https://www.utu.fi/fi/yksikot/tse/yksikot/PEI/raportit-jatietopaketit/Documents/Vahtra\\_Russian%20TNCs%20global%20economic%20crisi\\_2009%20web.pdf](https://www.utu.fi/fi/yksikot/tse/yksikot/PEI/raportit-jatietopaketit/Documents/Vahtra_Russian%20TNCs%20global%20economic%20crisi_2009%20web.pdf) [<https://perma.cc/L7U6-KLAB>]; see also Kari Liuhto, *Genesis of Economic Nationalism in Russia*, PAN-EUROPEAN INSTITUTE (2008), [https://www.utu.fi/fi/yksikot/tse/yksikot/PEI/raportit-jatietopaketit/Documents/Liuhto\\_32008.pdf](https://www.utu.fi/fi/yksikot/tse/yksikot/PEI/raportit-jatietopaketit/Documents/Liuhto_32008.pdf) [<https://perma.cc/Q53J-M4MH>] (arguing that Russian government control over companies that extract natural resources is part of a broader nationalist economic strategy); Nina Poussenkova, *The Global Expansion of Russia’s Energy Giants*, 63 COLUM. J. INT’L AFF. 103 (2010) (describing close ties between various Russian state-owned energy companies and the Russian government).

<sup>34</sup> Ewa Krukowska, *Russian Gas Link Extension May Face EU Law Compliance Risk*, BLOOMBERG (Feb. 4, 2016), <http://www.bloomberg.com/news/articles/2016-02-04/russian-nord-stream-2-gas-link-may-face-eu-law-compliance-risk> [<https://perma.cc/H4HT-JMQS>].

<sup>35</sup> See Mathieu Duchâtel, et al., *Protecting China’s Overseas Interests: The Slow Shift Away from Non-Interference*, STOCKHOLM INT’L PEACE RESEARCH INST. POL’Y PAPER 41, 34 (June 2014), <https://www.sipri.org/sites/default/files/files/PP/SIPRIPP41.pdf> [<https://perma.cc/JS85-AD7P>] (examining how China will use political influence and military power internationally in support of its national interests); see also Julie Jiang & Jonathan Sinton, *Overseas Investments by Chinese National Oil Companies: Assessing the Drivers and Impacts*, INT’L ENERGY AGENCY 12, 17 (2011), [https://www.iea.org/publications/freepublications/publication/overseas\\_china.pdf](https://www.iea.org/publications/freepublications/publication/overseas_china.pdf) [<https://perma.cc/KKL2-HRXL>] (arguing that commercial motives and securing supply to meet domestic energy demands drives state-owned investments abroad).

expand its strategic international influence.”<sup>36</sup> Geopolitical investments in the energy sector are thus often “hybrid”<sup>37</sup> or “chameleon”<sup>38</sup> 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.<sup>39</sup> 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.<sup>40</sup> 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

---

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

<sup>37</sup> Hillary Clinton, Sec’y of State, *Speech at the Economic Club of New York: Economic Statecraft* (Oct. 14, 2011), <https://2009-2017.state.gov/secretary/20092013clinton/rm/2011/10/175552.htm> [<https://perma.cc/E88V-VNGE>].

<sup>38</sup> Larry Backer, *Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance Through Private Global Investment*, 41 *GEO. J. INT’L L.* 425 (2010).

<sup>39</sup> See Nicholas Spykman, *Geography and Foreign Policy*, 1, 32 *AM. POL. SCI. REV.* 28, 43 (1938) (describing how every country’s perception of international relations changes with its geographical location).

<sup>40</sup> *Id.* See also FLINT, *supra* note 2, at 43 (listing changes in economic strength and military costs as a challenge to world leadership).

concerned.<sup>41</sup> Following shifts in strategic alliances, the host state can perceive<sup>42</sup> investments by the SOE from a previously allied state as a new “security externality” that requires regulatory intervention.<sup>43</sup>

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.<sup>44</sup> 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.<sup>45</sup> Import dependence was not to be

---

<sup>41</sup> 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).

<sup>42</sup> 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”).

<sup>43</sup> 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).

<sup>44</sup> 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 HÖGSELIUS, *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).

<sup>45</sup> See *Communication from the Commission to the European Council: External Energy Relations - From Principles to Action*, COM (2006) 590 final (Oct. 12, 2006),

reduced, but managed.<sup>46</sup> 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.<sup>47</sup> 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.<sup>48</sup>

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.<sup>49</sup> A key element in this energy security assessment is the level of energy dependence between the EU and the home country of the applicant<sup>50</sup>—a criterion that *de facto* targets Russian energy investors by taking into account EU dependence on

---

<http://ec.europa.eu/transparency/regdoc/rep/1/2006/EN/1-2006-590-EN-F1-1.Pdf> [<https://perma.cc/7ZHG-VRCM>] (discussing engagement with EU neighbors to achieve greater energy cooperation across the region).

<sup>46</sup> See, e.g., *Commission Green Paper: Towards a European Strategy for the Security of Energy Supply*, at 15, COM (2000) 769 final (2000) (assessing the EU's long-term strategic interests and the methods by which to achieve these goals).

<sup>47</sup> See Council of the European Union Press Release, Transport, Telecommunications and Energy Council Meeting, *Council Conclusions on "Energy Prices and Costs, Protection of Vulnerable Consumers and Competitiveness,"* COUNCIL MEETING (June 13, 2014), [http://www.consilium.europa.eu/uedocs/cms\\_Data/docs/pressdata/en/trans/143198.pdf](http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/trans/143198.pdf) [<https://perma.cc/69PW-UZ76>] (reviewing the EUs internal and external energy markets and the impact of those markets on consumers).

<sup>48</sup> *Communication from the Commission to the European Parliament and the Council: European Energy Security Strategy*, at 1, COM (2014) 330 final (May 28, 2014), [https://ec.europa.eu/energy/sites/ener/files/publication/European\\_Energy\\_Security\\_Strategy\\_en.pdf](https://ec.europa.eu/energy/sites/ener/files/publication/European_Energy_Security_Strategy_en.pdf) [<https://perma.cc/N9QH-PH8V>].

<sup>49</sup> See Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 Concerning Common Rules for the Internal Market in Natural Gas and Repealing Directive 2003/55/EC, art 11, 2009 O.J. (L211) 94, 95 (requiring Member States to implement security reviews of foreign investments in the electricity and natural gas transmission infrastructure).

<sup>50</sup> *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.<sup>51</sup> 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.<sup>52</sup> Russia also regularly accuses the EU Commission of engaging in “politically motivated interpretations of EU regulation”<sup>53</sup> aimed at “expropriat[ing] Gazprom’s assets” in the EU.<sup>54</sup>

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.<sup>55</sup> 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”

---

<sup>51</sup> See Thomas Cottier, et al., *Third Country Relations in EU Unbundling of Natural Gas Markets: The “Gazprom Clause” of Directive 2009/73 EC and WTO Law* (WORLD TRADE INSTITUTE, NCCR TRADE REGULATION, UNIVERSITY OF BERN, SWITZERLAND, WORKING PAPER NO. 2010/06, [http://www.nccr-trade.org/fileadmin/user\\_upload/nccr-trade.ch/wp5/Access%20to%20gasgrids.pdf](http://www.nccr-trade.org/fileadmin/user_upload/nccr-trade.ch/wp5/Access%20to%20gasgrids.pdf) [<https://perma.cc/F2C2-EDJ8>] (assessing the Gazprom clause under WTO law).

<sup>52</sup> See Permanent Court of Arbitration, *OAO Gazprom (Russian Federation) v. The Republic of Lithuania*, (2013) (case interrupted), in PERMANENT COURT OF ARBITRATION ANNUAL REPORT 22 (2014), <https://perma.cc/A3Z8-2S47> (reporting Gazprom’s claim arising out of the alleged forced divestiture of its investment in gas distribution in Lithuania).

<sup>53</sup> Goldthau, *supra* note 13, at 22.

<sup>54</sup> Goldthau, *supra* note 13, at 19. See also Marek Martyniszyn, *The EU’s Case Against Gazprom Is About Far More than Business*, THE CONVERSATION (Apr. 24, 2015), <http://theconversation.com/the-eus-case-against-gazprom-is-about-far-more-than-business-40773> [<https://perma.cc/KDM3-7HJP>] (analyzing EU-Russia relations through a Gazprom lens); Jonathan Stern et al., *Does the Cancellation of South Stream Signal a Fundamental Reorientation of Russian Gas Export Policy?*, THE OXFORD INSTITUTE FOR ENERGY STUDIES (Jan. 2015), <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2015/01/Does-cancellation-of-South-Stream-signal-a-fundamental-reorientation-of-Russian-gas-export-policy-GPC-5.pdf> [<https://perma.cc/A2GT-XQ5L>] (discussing the Gazprom-EU discourse regarding the South Stream infrastructure project).

<sup>55</sup> 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.<sup>56</sup> As highlighted by the *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.<sup>57</sup>

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.<sup>58</sup> The

---

<sup>56</sup> See, e.g., Sebastien Peyrouse, *Central Asia's Tortured Chinese Love Affair*, EAST ASIA FORUM (Nov. 30, 2016), [http://www.eastasiaforum.org/2016/11/30/central-asias-tortured-chinese-love-affair/?utm\\_source=subscribe2&utm\\_medium=email&utm\\_campaign=postnotify&utm\\_id=53297&utm\\_title=Central+Asia%26rsquo%3Bs+tortured+Chinese+love+affair](http://www.eastasiaforum.org/2016/11/30/central-asias-tortured-chinese-love-affair/?utm_source=subscribe2&utm_medium=email&utm_campaign=postnotify&utm_id=53297&utm_title=Central+Asia%26rsquo%3Bs+tortured+Chinese+love+affair) [<https://perma.cc/22KD-6UQS>] (highlighting the effects of China's increasing influence in central Asia).

<sup>57</sup> Beijing Shougang Mining Inv. Co. Ltd. v. Mongolia (Perm. Ct. Arb. 2017). See also Sergey Radchenko, *Sino-Russian Competition in Mongolia*, THE ASAN FORUM (Nov. 22, 2013), <http://mad-intelligence.com/sino-russian-competition-in-mongolia/> [<https://perma.cc/V6GD-HNSR>] (discussing the foreign investment competition between Russia and China in Mongolia); Leon Trakman, *Geopolitics, China, and Investor-state Arbitration*, in CHINA IN THE INTERNATIONAL ECONOMIC ORDER: NEW DIRECTIONS AND CHANGING PARADIGMS 268, 284 (Lisa Toohey et al. eds., 2015) (examining China's use of BITs to improve its economy and broaden its influence abroad).

<sup>58</sup> See, e.g., Meg Lippincott, *Depoliticizing Sovereign Wealth Funds Through International Arbitration*, 13 CHI. J. INT. L. 649 (2013) (assessing the impact of international arbitration on the ability to monitor sovereign wealth funds); Claudia Annacker, *Protection and Admission of Sovereign Investment under Investment Treaties*, 10 CHINESE J. INT. L. 531 (2011) (examining the role of the sovereign investor in investor-State arbitration); Skovgaard Poulsen, *supra* note 11 (highlighting increasing globalization of State capitalism and the potential need for reevaluating investment treaty provisions); Blyshak, *supra* note 9 (analyzing the status of State-owned enterprise in the realm of foreign investment); Mark Feldman, *The Standing of State-Owned Entities under Investment Treaties*, in YEARBOOK ON INTERNATIONAL INVESTMENT LAW AND POLICY 2010-2011 (Karl Sauvant ed., 2011) (discussing the role of state-owned entities under international investment treaties).

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.<sup>59</sup> 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)).<sup>60</sup>

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

---

<sup>59</sup> See North American Free Trade Agreement (NAFTA), Can.-Mex.-U.S., arts. 201, 1139, Dec. 17, 1992, 32 I.L.M. 289 (1993) (listing country-specific definitions and dispute-related definitions); Kazakhstan Bilateral Investment Treaty, U.S.-Kaz., May 19, 1992, U.S. DEPT. ST. (outlining agreed-upon BIT objectives between the United States and Kazakhstan); Kyrgyzstan Bilateral Investment Treaty, U.S.-Kyrg., Jan. 19, 1993, U.S. DEPT. ST. (outlining agreed-upon BIT objectives between the United States and Kyrgyzstan). See also other US BITs discussed in KENNETH VANDELDE, U.S. INTERNATIONAL INVESTMENT AGREEMENTS 122 (2009) (highlighting a 2004 modification to the United States’ model for its bilateral investment treaties).

<sup>60</sup> See DMITRII LABIN, MEZHDUNARODNOE PRAVO PO ZASHCHITE I POOSHCHRENIU INOSTRANNYKH INVESTITSII (2008); VADIM SILKIN, PRIAMYE INOSTRANNYE INVESTITSII V ROSSII – PRAVOVYE FORMY PRIVLECHENIIA I ZASHCHITY (2003); NORAH GALLAGHER & WENHUA SHAN, CHINESE INVESTMENT TREATIES: POLICIES AND PRACTICE (Loukas Mistelis ed., 2009) (analyzing the policies and practices around Chinese investment treaties). Cf. Agreement Between the Government of the People’s Republic of China and the Government of the Republic of Uzbekistan on the Promotion and Protection of Investments, China-Uzb., Apr. 19, 2011, MINISTRY OF COMMERCE OF THE PEOPLE’S REPUBLIC OF CHINA, DEPT. OF TREATY & LAW (outlining agreed-upon BIT objectives between the China and Uzbekistan).

cannot be limited in scope to “private investors.”<sup>61</sup> 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 entit[y],’” and thus qualifies as an “investor” within the meaning of the China-Mongolia investment treaty.<sup>62</sup> 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.<sup>63</sup>

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.”<sup>64</sup> Certain investment treaties expressly refer to “economic activities” or “business enterprises” in the definition of investment.<sup>65</sup> Arbitral tribunals have taken diverging approaches to

---

<sup>61</sup> 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://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).

<sup>62</sup> Beijing Shougang Mining Inv. Co. Ltd., et al. v. Mongolia, *supra* note 57, at ¶ 417.

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

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

<sup>65</sup> See, e.g., Energy Charter Treaty art. 1, ¶ 6, Dec. 17, 1994, 1994 O.J. (L 380) 24; Agreement Between the Czech Republic and the United Mexican States on the Promotion and Reciprocal Protection of Investments, Czech-Mex., art. 1, Mar. 13, 2004; Agreement Between the Lebanese Republic and the Republic of Iceland on the Promotion and Reciprocal Protection of Investments, Leb-Ice., art. 1, June 24, 2004; Agreement Between the People’s Republic of China and the Federal Republic

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.’”<sup>66</sup> 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.”<sup>67</sup> 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.<sup>68</sup>

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.”<sup>69</sup> In particular, the

---

of Germany on the Encouragement and Reciprocal Protection of Investments, China-Ger., art. 1, Nov. 11, 2005.

<sup>66</sup> *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”).

<sup>67</sup> *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.

<sup>68</sup> 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).

<sup>69</sup> *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.<sup>70</sup> 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.<sup>71</sup> 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.<sup>72</sup>

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.<sup>73</sup> 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.<sup>74</sup> Even in this case, international investment law does not condition access to arbitration to a market-economy test or a rational-investor test.<sup>75</sup> As

---

<sup>70</sup> *Id.*

<sup>71</sup> *Beijing Urban Construction Group v. Yemen*, Award, ICSID Case No. ARB/14/30, ¶ 42 (May 31, 2017).

<sup>72</sup> *Id.*

<sup>73</sup> *Salini Costruttori S.p.A and Italstrade S.p.A v. Kingdom of Morocco*, Decision on Jurisdiction, ICSID Case No. ARB/00/4, ¶ 52 (July 23, 2001) (discussing "the criteria to be used for the definition of an investment pursuant to the convention.").

<sup>74</sup> *See, e.g.*, Treaty Between the United States of America and the Oriental Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment, U.S.-Uru., art.1, Nov. 1, 2006. *See generally*, 2012 U.S. Model Bilateral Investment Treaty, <https://ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf>.

<sup>75</sup> 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.”<sup>76</sup>

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).<sup>77</sup> However, finding conclusive evidence of the strategic rationale of an investment is a most delicate task.<sup>78</sup> 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>].

<sup>76</sup> *Allard v. Barbados*, Decision on Jurisdiction, PCA Case Repository No. 2012-06, ¶ 51 (Perm. Ct. Arb. 2014).

<sup>77</sup> See, e.g., *Pastanavlenie Pravitel’stva RF July 30, 2009 No. 1063-r ‘O podpisanii Soglasheniia mezhdru Pravitel’stvom Rossiiskoi Federatsii i Pravitel’stvom Respubliki Tadzhikistan o Sotrudnichestve po Ekspluatatsii Sangtudinskoi GES-1’*, SOBRANIE ZAKONODATEL’SIVA RF 4055 (Aug. 10, 2009); *Pastanavlenie Pravitel’stva RF Apr.6 2013 No. 299 ‘O vnesenii na ratifikatsiiu Soglasheniia mezhdru Pravitel’stvom Rossiiskoi Federatsii i Pravitel’stvom Kirgizskoi Respubliki o Stroitel’stve i Ekspluatatsii Kambaratinskoi GES-1’*, SOBRANIE ZAKONODATEL’SIVA RF 1805 (Apr. 15, 2013).

<sup>78</sup> 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.<sup>79</sup> With “hybrid companies masquerading as commercial actors, but actually controlled by states and acting with strategic consequences,”<sup>80</sup> 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.<sup>81</sup> 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.<sup>82</sup> 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.<sup>83</sup> A closely related question is

---

27, 2017) (ruling that “the chronology of the facts taken as a whole” can provide evidence of the “real motivation” behind parties’ actions).

<sup>79</sup> See Section II.A, *infra*.

<sup>80</sup> Clinton, *supra* note 37.

<sup>81</sup> 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 (Shaheezah Lalani & Rodrigo Polanco eds., 2015).

<sup>82</sup> 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).

<sup>83</sup> 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”<sup>84</sup> and “objective legal criteria”?<sup>85</sup>

#### 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.<sup>86</sup> In some cases, national law can even explicitly foresee the possibility to reopen security reviews

---

ENVIRONMENT IN INTERNATIONAL LAW (2015) (analyzing the major challenges facing States and foreign investors as a result of the friction between investment law and environmental law); *see generally* AIKATERINI TITI, THE RIGHT TO REGULATE IN INTERNATIONAL INVESTMENT LAW (2014) (discussing States' and regional organisations' right to regulate under specific public policy objectives to safeguard their regulatory power and delimit tribunals' interpretive power); CAROLINE HENCKELS, PROPORTIONALITY AND DEFERENCE IN INVESTOR-STATE ARBITRATION: BALANCING INVESTMENT PROTECTION AND REGULATORY AUTONOMY (2015) (examining how investment tribunals have balanced the competing interests of host states and foreign investors in determining state liability in disputes concerning the exercise of public power).

<sup>84</sup> Allard v. Barbados, *supra* note 76, at ¶ 46; Peter Allard v. Barbados, PCA Case No. 2012-06, Award, ¶ 84 (Perm. Ct. Arb. 2016).

<sup>85</sup> *See* Christoph Schreuer, *Investment Protection and International Relations, in* THE LAW OF INTERNATIONAL RELATIONS—LIBER AMICORUM HANSPETER NEUHOLD 345, 347 (August Reinisch & Ursula Kriebaum eds., 2007) (discussing the balancing of interests of the parties concerned in arbitration); CHRISTOPH SCHREUER, THE ICSID CONVENTION: A COMMENTARY 416 (2d ed. 2009) (discussing advantages to each party in arbitration).

<sup>86</sup> *See, e.g.,* Total S.A. v. Argentina, Decision on Liability, ICSID Case ARB/04/1, ¶ 312 (Dec. 27, 2010); El Paso Energy International Company v. Argentina, Award, ICSID Case ARB/03/15, ¶ 374 (Oct. 31, 2011); Charanne B.V. Construction Investments S.A.R.L. v. Spain, Award, SCC ARB 062/2012, ¶ 490 (Jan. 21, 2016) (considering the importance of stabilization commitments for the protection of investors' expectations under the fair and equitable treatment standard).

for existing investments and adopt additional security requirements if this is necessary to address new security risks.<sup>87</sup> 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.<sup>88</sup>

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.<sup>89</sup> 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.<sup>90</sup>

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

---

<sup>87</sup> 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.

<sup>88</sup> See Section II.B, *infra*.

<sup>89</sup> 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, *Australia Courts U.S., Canada After Rejecting Chinese Bids for Ausgrid*, REUTERS (Sept. 13, 2016), <http://www.reuters.com/article/us-australia-privatisation-ausgrid-idUSKCN11K07E> [<https://perma.cc/QH4J-7SLC>].

<sup>90</sup> *Noble Ventures, Inc. v. Romania*, ICSID Case ARB/01/11, Award, ¶ 180 (Oct. 12, 2005). See also RUDOLF DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* 200-01 (2012) (discussing various considerations in defining differentiation); Andrea Bjorklund, *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.<sup>91</sup> 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.<sup>92</sup> 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.<sup>93</sup> Although *de jure* EU law remains neutral on the energy security requirements of non-EU companies, there are clear risks of *de facto* discrimination in the application of the Gazprom Clause, and EU energy and competition law more generally.<sup>94</sup> 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.<sup>95</sup>

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.<sup>96</sup> By analyzing the strategic use (infrastructure diplomacy) that certain states make of foreign investments in strategic assets,<sup>97</sup> the economic statecraft and geopolitical theories explain how investments by the SOE of a

---

<sup>91</sup> See Section II.B, *infra*.

<sup>92</sup> European Commission, *supra* note 48, at 1.

<sup>93</sup> EUROSTAT, EU Imports of Energy Products - Recent Developments (October 2018), [https://ec.europa.eu/eurostat/statistics-explained/index.php/EU\\_imports\\_of\\_energy\\_products\\_-\\_recent\\_developments#Main\\_suppliers\\_of\\_natural\\_gas\\_and\\_petroleum\\_oils\\_to\\_the\\_EU](https://ec.europa.eu/eurostat/statistics-explained/index.php/EU_imports_of_energy_products_-_recent_developments#Main_suppliers_of_natural_gas_and_petroleum_oils_to_the_EU) [<https://perma.cc/2VUB-V5X5>].

<sup>94</sup> 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).

<sup>95</sup> *Ralls Corp. v. Comm. on Foreign Inv. in U.S.*, 758 F.3d 296 (D.C. Cir. 2014).

<sup>96</sup> 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. 48, 72 (2008).

<sup>97</sup> See Section II.A, *infra*.

non-allied state can be a “legitimate concern” for the host state.<sup>98</sup> Moreover, the theory on the dynamic nature of geopolitics<sup>99</sup> 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.”<sup>100</sup>

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.<sup>101</sup> 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.<sup>102</sup> “Some measure of inefficiency, a degree of trial and error, [and] a modicum of human imperfection” are permissible.<sup>103</sup>

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

---

<sup>98</sup> 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, *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).

<sup>99</sup> See Section II.B, *infra*.

<sup>100</sup> Vandevelde, *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.”).

<sup>101</sup> See Section II.B, *infra*.

<sup>102</sup> 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, *Good Faith and Fair and Equitable Treatment in International Investment Law*, in *GOOD FAITH AND INTERNATIONAL ECONOMIC LAW* 143 (Andrew D. Mitchell et al. eds., 2015) (discussing the role of good faith in international investments).

<sup>103</sup> 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.<sup>104</sup> In *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.<sup>105</sup> 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."<sup>106</sup>

Similarly, according to *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."<sup>107</sup> According to *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.<sup>108</sup> According to *Tokios Tokelés v. Ukraine*, a "deliberate campaign to punish [a

---

<sup>104</sup> 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 "politicization . . . 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").

<sup>105</sup> *Ampal-American Israel Corp. v. Egypt*, ICSID Case ARB/12/11, Decision on Liability and Heads of Loss, ¶ 344 (Feb. 21, 2017).

<sup>106</sup> *Id.*

<sup>107</sup> *Cargill, Inc. v. Mexico*, ICSID Case ARB(AF)/05/2, Award, ¶¶ 209, 220 (Sept. 18, 2009).

<sup>108</sup> *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.”<sup>109</sup>

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.<sup>110</sup> The security measure must be “taken *because of*”<sup>111</sup> the perceived security risks characterizing the strategic investment, and not to achieve an abstract objective,<sup>112</sup> 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).<sup>113</sup> On this basis, regulatory

---

<sup>109</sup> 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.

<sup>110</sup> *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”).

<sup>111</sup> *Cargill*, *supra* note 107, at ¶ 204.

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

<sup>113</sup> 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.<sup>114</sup> 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.<sup>115</sup> According to *Saluka Investments v. Czech Republic*, the failure of the host state to disclose the rationale underlying a discriminatory measure can

---

single or a few TSOs to violate their obligations under EU law or to act contrary to their commercial interests" (¶ 7.1199).

<sup>114</sup> Tecmed, *supra* note 112, at ¶ 154. See generally *Maffezini 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).

<sup>115</sup> *Ralls Corporation v. CFIUS*, *supra* note 95.

amount to a violation of the fair and equitable treatment standard.<sup>116</sup> 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,<sup>117</sup> such as entering into a partnership with an investor from the host state or an allied State.<sup>118</sup>

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*,<sup>119</sup> 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.<sup>120</sup> Applying an objective standard of vigilance of the state,<sup>121</sup> the majority of the tribunal ruled that the government should have tried peaceful communication before undertaking military action against the investment.<sup>122</sup> The majority's decision generated criticism for second-guessing the

---

<sup>116</sup> *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).

<sup>117</sup> *Saluka*, *supra* note 66, at ¶¶ 420–25.

<sup>118</sup> *See e.g.*, Andrew Ward & Jim Pickard, *Hinkley Go-ahead after 'National Security' Safeguards*, FIN. TIMES (Sept. 16, 2016), <https://www.ft.com/content/0cde26b6-7b66-11e6-b837-eb4b4333ee43> [<https://perma.cc/3HPY-KVJT>] (detailing Theresa May's approval of the Hinkley Deal and the new conditions and requirements accompanying the approval); Francois De Beaupuy, *U.K. Approves EDF's £18 Billion Hinkley Point Nuclear Project*, BLOOMBERG (Sept. 15, 2016), <https://www.bloomberg.com/news/articles/2016-09-14/u-k-said-to-approve-edf-s-18-billion-pound-nuclear-project-it39ityn> [<https://perma.cc/SN7X-ZTFS>] (detailing the approval of Hinkley Point C and Chinese involvement in the plan).

<sup>119</sup> *Asian Agricultural Products Ltd. (AAPL) v. Sri Lanka*, Award, ICSID Case ARB/87/3 (June 27, 1990).

<sup>120</sup> *See* Stephen Vasciannie, *Bilateral Investment Treaties and Civil Strife: The AAPL/Sri Lanka Arbitration*, 34 NETHERLANDS INT'L L. REV. 332, 334 (1992).

<sup>121</sup> *AAPL*, *supra* note 119, at ¶ 77.

<sup>122</sup> *Id.* at ¶ 84.

modalities and timing of a “strategic and highly sensitive security operation to regain its sovereign control of the area of insurgency.”<sup>123</sup> 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.<sup>124</sup> 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.”<sup>125</sup>

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.

---

<sup>123</sup> Samuel Asante, Dissenting Opinion in *AAPL*, *supra* note 119.

<sup>124</sup> 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.

<sup>125</sup> 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.<sup>126</sup> 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.<sup>127</sup>

Arbitral Tribunals accept that economic emergencies, and not just military security, can qualify as an essential security interest of the state.<sup>128</sup> 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."<sup>129</sup> 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.<sup>130</sup> 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

---

<sup>126</sup> 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).

<sup>127</sup> UNCTAD, *supra* note 6, 72-102.

<sup>128</sup> *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.).

<sup>129</sup> *LG&E Energy Corp. v. Argentina*, ICSID Case ARB/02/1, Decision on Liability, ¶ 238 (Oct. 3, 2006).

<sup>130</sup> 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,”<sup>131</sup> 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.<sup>132</sup> By allowing for “the subjective evaluation of the State claiming the derogation,”<sup>133</sup> 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.<sup>134</sup> 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.

---

<sup>131</sup> Oil Platform (Iran v U.S.), Judgment, 2003 I.C.J. 161, ¶ 73 (November 2003). See also Yuval Shany, *Toward a General Margin of Appreciation Doctrine in International Law?*, 16 EUR. J. INTL. L. 907, 926 (2006) (“... “some international courts provide states with wider margins of discretion in security-related matters”); Lisa Bohmer, *Another Indian BIT Award Surfaces, Revealing Divergence between A Pair of Tribunals with Respect to Application of “Essential Security” Clauses*, Investment Arbitration Reporter, Sept. 17, 2018, <https://www.iareporter.com/articles/another-indian-bit-award-surfaces-revealing-divergence-between-a-pair-of-tribunals-with-respect-to-application-of-essential-security-clauses/> [https://perma.cc/6TNR-UF6W] (reporting on the *Deutsche Telekom AG (DT) v. India BIT* dispute). But see the majority in *CC/Devas Ltd., Devas Employees Mauritius Private Limited, and Telcom Devas Mauritius Limited v. The Republic of India*, Award on Jurisdiction and Merits, Perm. Ct. Arb. 2016, ¶¶ 244–45 (“The Tribunal has also no difficulty in recognizing the ‘wide measure of deference . . .’. National security issues relate to the existential core of a State. An investor who wishes to challenge a State decision in that respect faces a heavy burden of proof, such as bad faith, absence of authority or application to measures that do not relate to essential security interests.”)

<sup>132</sup> Stephan Schill & Robyn Briese, *If the State Considers: Self-Judging Clauses in International Dispute Settlement*, 13 MAX PLANCK Y.B. U.N. L. 61, 63 (2009).

<sup>133</sup> *Id.* at 68.

<sup>134</sup> 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. At the same time, geopolitical tensions between the host and home states can expose SOEs to politically motivated measures designed to punish or influence the home state's government.

Despite the objective to "remove investment disputes from the intergovernmental political sphere,"<sup>135</sup> 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.

---

<sup>135</sup> Aron Broches, *Settlement of Investment Disputes*, in *SELECTED ESSAYS: WORLD BANK, ICSID AND OTHER SUBJECTS OF PUBLIC AND PRIVATE INTERNATIONAL LAW* 161, 163 (Aron Broches ed. 1995).

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.<sup>136</sup> 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"<sup>137</sup> 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

---

<sup>136</sup> See generally Henckels, *supra* note 125.

<sup>137</sup> 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.