

Working Draft:

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Legitimate Countermeasures in International Trade Law and their Illegality in International Investment Law

by Junianto James Losari² and Michael Ewing-Chow³

I.	Introduction.....	2
II.	Countermeasures in International Law	3
III.	Countermeasures in International Trade Law	6
	A. WTO DSU as Lex Specialis.....	6
	B. Requirements for a Lawful Trade Countermeasure	9
	1. Proper Subject.....	9
	2. Level of Countermeasure	11
	3. Non-retroactive Remedies.....	12
	4. Prior Authorization from the DSB	12
	C. Various Countermeasures in the WTO	12
IV.	Countermeasures in International Investment Law.....	14
	A. The Facts of the US – Mexico Sugar War	15
	B. Contextualizing the NAFTA Dispute Settlement Bodies	16
	C. Countermeasures Analysis by Investor-State Arbitration Tribunals.....	17
	1. Availability of the defence of Countermeasures under NAFTA Chapter 11	17
	2. Jurisdiction over the Defence of Countermeasures.....	21
	3. Criteria of Countermeasures	23
V.	Resolving the Tension on Countermeasures between Trade and Investment Law	26
	A. Individual Rights in International Investment Law	26
	1. Substantive v. Procedural or False Dichotomy?	26
	2. Historical Development of Individual Rights in International Law.....	27
	3. Textual Interpretation of the IIAs	29
	4. Interpretation of the Treaty and General International Law	31
	5. Implementing the Intermediate Theory.....	31
	B. Issuance of Joint-Interpretation of the Treaty by the State Parties	32
	C. Write into BITs and IIAs a clause that says if WTO-authorized it is not a breach.....	34
VI.	Conclusion	34

¹ Comments can be sent to ciljil@nus.edu.sg or lawmec@nus.edu.sg.

² Research Associate, Centre for International Law (CIL) (www.cil.nus.edu.sg).

³ Associate Professor, National University of Singapore, WTO Chair, Head Trade/Investment Law and Policy, Centre for International Law (CIL) (www.cil.nus.edu.sg).

I. Introduction

The defence of countermeasures is well accepted in Public International Law as a part of Customary International Law (CIL). Even so, the issue of when unilateral countermeasure is legitimate as a response to a breach of international obligation has always been a problem in international law. We continue trying to understand and setting parameter of unilateral actions of states through numerous criteria as can be seen in the Draft Articles on State Responsibility (ILC Articles).¹ Under Article 22 ILC Articles, although a state may breach its international obligation against another state, the wrongfulness of the breach can be precluded if the former can demonstrate that its act constitutes a legitimate countermeasure taken against a breach done earlier against it, in accordance with the requirements in the ILC Articles.

In Public International Law, without an international police system controlling enforcement of states' obligations, states have very little options than to use its power or even coercion against the breach of international obligations. Although dispute settlement mechanisms (DSMs) seem to offer a solution in order to seek states' compliance with their international obligations, in reality states are faced with political pressure internally leading to non-compliance with DSM decisions. In this situation, countermeasures become a resort for the injured state to obtain compliance from the breaching state.

In the initial development, we have seen that even the ILC Articles addressed mostly countermeasures in the use of force with few exceptions. However, some recent cases in International Economic Law field emphasized the need to resolve the issue of countermeasures and the tensions arising in the field. As such, trade and investment lawyers have been posed with the question of how to regulate countermeasures in the fields.

In International Trade Law, this defence is formally incorporated in the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) of the World Trade Organization (WTO). Under the agreement, a state found in violation of its WTO obligation (Respondent) must comply with the recommendations and rulings issued by a panel or the Appellate Body within a reasonable period of time. Article 22(2) DSU provides that in the event the state fails to do so, it should enter into negotiation with the complaining state (Complainant) to determine a mutually acceptable compensation. If no agreement can be reached, the Complainant may request for an authorization from the Dispute Settlement Body (DSB) to suspend the application of concessions or other WTO obligations to the Respondent. This suspension of concessions or other WTO obligations is more popularly known with the term 'retaliation'. However, we are going to refer it as countermeasures for the purpose of this discussion.

In contrast, this defence cannot be found in any investment agreement. Nevertheless, an arbitral tribunal had incorporated it into an investment agreement as a defence of CIL.² In doing so, it relied heavily on the ILC Articles and past cases³ to determine the legitimacy of the countermeasure.⁴

¹ International Law Commission, *Draft Articles on Responsibility of States for Internationally Wrongful Acts with commentaries*, Yearbook of International Law Commission, 2001, vol. II, Part Two [ILC Articles Commentary].

² *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. Mexico*, ICSID ARB(AF)/04/5, Award, 21 November 2007 [*ADM v. Mexico*], ¶111, 121.

³ *Case Concerning the Gabčíkovo-Nagymaros Project* (Hungary/Slovakia), ICJ, Judgment of 25 September 1997 [*Gachikovo – Nagymaros*]; *Portuguese Colonies case [Cysne]*, UNRIAA, vol. II (Sales No. 1949.V.1), p. 1035, at p. 1052 (1930); *Portuguese Colonies case [Naulilaa]*, UNRIAA, vol. II (Sales No. 1949.V.1), p. 1011, at pp. 1025–1026 (1928).

⁴ *ADM v. Mexico*, *supra* note 2, ¶121, 125.

Legitimate countermeasures under WTO Law may affect private individuals' interests, including foreign investors. In the event where there is an investment agreement between two disputing WTO Members, an investor of one of the members who might be impacted by a countermeasure may bring a claim of violation of the investment agreement against the other member, provided it is covered as an investor under the agreement.

The likelihood of such a situation is not remote, considering how closely trade and investment are interrelated in this globalized world with the Global Value Chains (GVCs). Manufacturing is no longer the same as it was because with this business structure, various multinational companies (MNCs) are present in many different parts of the world. For example, this relationship is apparent in the Sugar War between Mexico and the United States (US) in which Mexico's so-claimed trade-related countermeasures happened to affect American investors in Mexico.⁵ Mexico's countermeasures were not taken as a countermeasure under WTO Law but the North American Free Trade Agreement (NAFTA).⁶ However using this case as an illustration, we are faced with an important question as to whether legitimate countermeasures taken under the bigger trade regime of the WTO which may affect investors' rights under an investment agreement can be raised as a legitimate defence before an investor-state arbitration tribunal. A negative response to this question may create a clash between the two regimes significantly restricting states' options to enforce their legitimate trade interests, and even worse it may remove the value of countermeasures as an effective tool to ensure compliance in the Dispute Settlement Mechanism.

This paper is a continuation from the analysis that was conducted by one of the authors in his previous paper on convergence and divergence between trade and investment law. This paper seeks to explore this issue in a greater detail, and it will be done in the following sequence. Part II will briefly describe the defence of countermeasures in Public International Law. Part III will analyze countermeasures in International Trade Law, specifically in WTO Law. Part IV will analyze the defence of countermeasures in International Investment Law by probing through arbitral awards that have dealt with the matter. Part V will explore the interaction of countermeasures in International Trade Law and International Investment Law, and provide recommendations thereof. Part VI will be the conclusion.

II. Countermeasures in International Law

In CIL, the defence of countermeasures precludes the wrongfulness of an internationally wrongful act by a state taken as a response to an internationally wrongful act done to it. Legitimate countermeasures should only seek for cessation and/or to obtain reparation for the injury caused, instead of acting as a punishment.⁷ An internationally wrongful act exists when an action or omission 1) constitutes a breach of an international obligation of a state, and 2) is attributable to the State.⁸

Countermeasures under CIL are historically unilateral actions.⁹ It may be taken by a state at its own risk and may incur responsibility if it is later found that the measure is not legitimate.¹⁰ This means there is neither the need for a determination by a tribunal that there has been an internationally wrongful act prior to the taking of the measure nor the need to obtain a prior authorization.

⁵ For further discussion on the convergence between the two fields: Alvaro Antoni and Michael Ewing-Chow, "Trade and Investment Convergence and Divergence: Revisiting the North American Sugar War", *Latin American Journal of International Trade Law* Vol. 1, Issue 1 (2013) [Antoni and Ewing-Chow], 321-325; Jürgen Kurtz, *The Use and Abuse of WTO Law in Investor-State Arbitration: Competition and its Discontents*, 20 *EJIL* 3, 749-771 (2009).

⁶ *North American Free Trade Agreement*, 32 *ILM* 289, 605 (1993).

⁷ ILC Articles Commentary, *supra* note 1, 75.

⁸ Article 2 ILC Articles.

⁹ The defence is formerly known as 'reprisals', but since *Air Services Agreement* arbitration, the term 'countermeasures' is preferred.

¹⁰ David Harris, *Cases and Materials on International Law*, 7th Ed., 2010 (London: Thomson Reuters), 460-461.

The coverage of countermeasures under International Law is very limited to preclude wrongfulness only against the wrongdoer.¹¹ The measure must be temporary,¹² and may not affect the following obligations: 1) obligation to refrain from the threat or use of force, 2) obligations for the protection of fundamental human rights, 3) obligations of a humanitarian character prohibiting reprisals, 4) obligations under peremptory norms of general international law.¹³

According to the International Court of Justice (ICJ) in *Gabčíkovo-Nagymaros*, a legitimate countermeasure has to fulfill several prerequisites, including 1) taken in response to a previous international wrongful act of another State, 2) directed against that State,¹⁴ 3) taken after a prior call upon the responsible state and prior offer to negotiate,¹⁵ and 4) proportionate.¹⁶ Additionally, the ILC Articles added other two conditions namely 1) temporary only during the existence of the wrongful act, and 2) not imposed when the dispute is pending before a court or tribunal.¹⁷

1. Existence of an Internationally Wrongful Act

A countermeasure must be taken against a breach of international obligation. Therefore, the existence of a breach is critical¹⁸ but does not have to be proven before an adjudicatory body prior to the taking of the countermeasure unless specified in a treaty or an agreement.

2. Targeted Party

A countermeasure must be ‘directed against’ the responsible state.¹⁹ In reality, this may not always be the case, and Article 49 ILC Articles notes the possibility of countermeasures incidentally affecting the interests of third parties, that indirect or collateral effects may not be entirely avoided.²⁰ Such indirect or consequential effects of countermeasures on third parties that do not involve an independent breach of any obligation to those third parties will not make the countermeasures illegitimate.²¹ Furthermore, the ILC Articles commentary provides that where the third parties have no individual rights in the matter, they cannot complain.

In *Cysne*,²² Germany retaliated against the breach of Great Britain’s treaty obligation not to carry certain items as contraband. In the course, Germany added more items to the list without authority and sank a Portuguese ship that carried them. The tribunal found that legitimate reprisals taken against the offending state may affect the nationals of an innocent state. The victim state should endeavor to avoid or to limit this indirect and unintentional consequence as far as possible.²³ Unfortunately the degree of endeavor is not clarified by any tribunal, thus may be contentious in many cases.

3. Offer to Negotiate

¹¹ Article 49 (1) ILC Articles.

¹² *Ibid*, Articles 30 and 31.

¹³ *Ibid*, Article 50 (1) ILC.

¹⁴ *Gabčíkovo-Nagymaros*, *supra* note 3, ¶83.

¹⁵ *Ibid*, ¶84; Article 52(1)(a) ILC Articles, with a possibility of waiving this requirement where the state takes an urgent countermeasure that is necessary to preserve its rights.

¹⁶ *Gabčíkovo-Nagymaros*, *supra* note 3, ¶85.

¹⁷ See Article 49-53 ILC Articles for a full list of the conditions.

¹⁸ *Naulilaa*, *supra* note 3, 1027.

¹⁹ ILC Articles Commentary, *supra* note 1, 76; *Gabčíkovo-Nagymaros*, ¶83.

²⁰ ILC Articles Commentary, *supra* note 1, 130.

²¹ *Ibid*, 75.

²² *Cysne*, *supra* note 3, 1057.

²³ *Ibid*, 1056-1057.

The state taking a countermeasure must provide a notice or warning to the targeted state.²⁴ The rationale of this requirement is to provide the latter the opportunity to present a response or to reconsider its position. In *Naulilaa*, the arbitral tribunal mentioned that the condition would be fulfilled only after the warning had been given continuously but remained unproductive.²⁵ The ILC Articles clarifies that the existence of negotiations will suffice to fulfill the requirement.²⁶ However, this requirement is not absolute when urgent countermeasures need to be taken to preserve the states' rights. For example, countermeasures in the form of temporary stay orders or temporary freezing of assets may not require prior notification because the targeted state may frustrate the measures.²⁷

4. Proportionality

In *Naulilaa*, the tribunal required proportionality between the reprisal and the breach.²⁸ This requirement is then stipulated in Article 51 ILC Articles. It provides that countermeasures must be commensurate with the injury suffered, taking into account the gravity of the internationally wrongful act and the rights in question.

In *Air Services Agreement* arbitration, proportionality was initially assessed based on the degree of equivalence with the alleged breach. The tribunal acknowledged that the test could at best be accomplished by approximation, and that question of principle had to be taken into account. In that case, the principle considered was the general air transport policy of the US.²⁹ This was confirmed by the decision of *Gabčíkovo-Nagymaros* where the ICJ took into account the quality or character of the rights in question as a matter of principle, and not only assessment in quantitative terms. In this case, the principle considered was Hungary's "right to an equitable and reasonable share of the natural resources of the Danube".³⁰

Additionally, the commentary to Article 49 (2) ILC Articles also acknowledges a circumstance when a particular countermeasure may affect the performance of several obligations simultaneously. An example could be seen in the freezing of the assets of a State which could potentially breach several obligations to that State under different agreements. The ILC Articles believes that countermeasures can be taken in the realm of another set of international obligations contained in another treaty and not confined to the initial treaty that the wrongdoer has breached. However, the test of proportionality will be applicable to determine the legitimacy of the measure.³¹

5. Temporary

Article 49 (2) ILC Articles provides that countermeasures may be taken only for the non-performance for the time being of international obligations. Due to its nature as inducement and not punishment, countermeasures should be discontinued once the responsible state has complied with its obligations of cessation and reparation.³² Moreover, countermeasures in essence have to be reversible.³³ However, this

²⁴ Article 52 (1) (a) and (b) ILC Articles.

²⁵ *Naulilaa*, *supra* note 3, 1027-1028.

²⁶ ILC Articles Commentary, *supra* note 1, 136, ¶4-5.

²⁷ *Ibid*, 136, ¶6.

²⁸ *Naulilaa*, *supra* note 3, 1028.

²⁹ *Air Services Arbitration Case* (France v. United States), 1978, 18 RIAA 416 [*Air Services Arbitration*], ¶83.

³⁰ *Gabčíkovo-Nagymaros*, *supra* note 3, ¶85-87.

³¹ ILC Articles Commentary, 130.

³² Article 53 of the ILC Articles; *Ibid*, 131, ¶7.

³³ *Gabčíkovo-Nagymaros*, *supra* note 3, ¶87.

requirement is not absolute because some effects of countermeasures may be impossible to reverse, such as notification requirement of some activity.³⁴

6. Absence of an impending dispute

Article 52(3)(b) ILC Articles provides that when there is an impending dispute that has been brought to a tribunal, countermeasures may not be taken against the alleged breach. A dispute is pending if a court or tribunal exists and is in position to deal with the case. The tribunal needs to be actually constituted, and this may take some time even if both parties are cooperating in the appointment of the members of the tribunal.³⁵ This indicates that under CIL, a countermeasure may be taken as a form of self-help prior to any decision by an arbitral tribunal regarding the initial breach, provided it has not been brought to the tribunal.

In *Air Services Arbitration*, the tribunal held that the right to retaliation was not restricted even when there was a duty to submit the dispute to arbitration, provided that the retaliation was designed to hasten rather than to impede the arbitration.³⁶ The right to initiate countermeasure or to sustain an existing countermeasure ceases only when a tribunal has been established and it has power to decide on interim measures of protection.³⁷

Article 50(2)(a) ILC Articles provides that when the state has taken a countermeasure, it remains subject to its obligations under any dispute settlement procedure applicable between it and the responsible state. This includes the dispute settlement for the initial dispute over the initial internationally wrongful act and the question of legitimacy of the countermeasure taken in response.³⁸

These requirements for a legitimate defence of countermeasures under CIL are important for our further analysis of the defence in International Trade Law and International Investment Law regimes.

III. Countermeasures in International Trade Law

A. WTO DSU as *Lex Specialis*

For the purpose of this discussion, International Trade Law refers more specifically to the regime of WTO Law, despite the existence of various free trade agreements (FTAs) which regulate similar matter.

During the General Agreement on Tariff and Trade 1947 era, prior to the adoption of the WTO DSU in the Uruguay Round, Article XXIII:2 GATT was the main rule regulating retaliation. This provision required authorization from the Contracting Parties of the GATT for any retaliatory action taken. However, there was no clear rule on type of action to be taken.

Perhaps, this is one of the reasons that the US could issue Section 301 of the Trade Act as a self-help or unilateral sanctions which allowed the US to attack, in the US, the acts, policies, or practices of foreign governments or their instrumentalities that adversely affected the US commerce including, but not limited to, barriers to US export commerce.³⁹ With this Act, the US had taken retaliatory action in certain cases,

³⁴ ILC Articles Commentary, *supra* note 1, 131, ¶9.

³⁵ *Ibid*, 136, ¶8.

³⁶ *Air Services Arbitration*, *supra* note 29, ¶84-89, 95.

³⁷ *Ibid*, ¶96.

³⁸ ILC Articles Commentary, *supra* note 1, 133, ¶12.

³⁹ Josh Schein, "Section 301 and US Trade Law: The Limited Impact of the 1988 Omnibus Trade and Competitiveness Act on American Obligations under GATT" (1992) *Pac Rim Law and Policy Journal* 105, 109, citing 19 USC § 2411 (Supp 1980).

claiming that a foreign government had blocked adoption of GATT Panel report against it.⁴⁰ When the WTO DSU came into being, Article 22.4 changed this. The US issued a statement that it had “explicitly, officially, repeatedly and unconditionally confirmed the commitment expressed in the SAA namely that the USTR would ‘... base any section 301 determination that there has been a violation or denial of U.S. rights under the relevant agreement on the panel or Appellate Body findings adopted by the DSB’”.⁴¹

The WTO DSU, one of the cornerstones of the 1994 Marrakesh Agreement Establishing the WTO, is a *lex specialis* that regulates countermeasures for the enforcement of WTO Law.⁴² The language that it uses is suspension of concessions, but for the purpose of this article, we will refer to it as countermeasures. The WTO DSU specifically applies to disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 of the DSU:⁴³ 1) Multilateral agreements on trade in goods, 2) GATS, 3) TRIPs, 4) WTO DSU, 5) Plurilateral trade agreements. This means that the applicable law to the WTO DSB are limited to the abovementioned agreements.⁴⁴ In effect, panels or the appellate body of the WTO DSU cannot decide on disputes brought to it under any different agreement, including FTA to which the disputing members are parties to.⁴⁵

The DSU is a self-contained regime within international law that does not allow WTO Members to resort to rules of countermeasures under CIL. This includes barring WTO Members from taking unilateral countermeasures when it alleges a breach of WTO Law by another Member.⁴⁶

The case of *Mexico-Soft Drinks* is a good example of how a Member may have been politically presumed to resort to unilateral countermeasures. Mexico claimed that its measures on soft drinks were necessary to secure compliance with laws or regulations, i.e. the US’ obligations under NAFTA. Mexico characterized its actions as an exercise of countermeasures recognized under international law.⁴⁷ The panel suggested two findings when assessing the matter, namely 1) examples provided in Article XX (d) are a significant indicator of the intended interpretation that securing compliance with laws or regulations relates to those obligations at the domestic sphere,⁴⁸ and 2) countermeasures in the ILC Articles does not relate to enforcement instrument as argued by Mexico, but inducing compliance instrument.⁴⁹ For those reasons, it opined that Article XX(d) was not meant to accommodate a Member taking a countermeasure for obligations owed under non-WTO treaty against another Member.⁵⁰ The AB provided a clearer reasoning to reject Mexico’s argument. It opined that if international countermeasures were accommodated by Article XX(d), this would allow unilateral and WTO unsanctioned countermeasures, in contradiction with Articles 22 and 23 of the DSU.⁵¹ At the same time, this would require WTO adjudicative bodies to decide whether there was a violation of the relevant extra-WTO international

⁴⁰ US Statement of Administrative Action [SAA], 366-367.

⁴¹ *Ibid*, 366 as mentioned in Panel Report, *US-Sections 301-310 of the Trade Act of 1974*, 22 December 1999, WT/DS152/R, ¶7.115.

⁴² See also Article 4.10-4.11 of the Agreement on Subsidies and Countervailing Measures [SCM Agreement].

⁴³ Article 1(1) Understanding on Rules and Procedures Governing the Settlement of Disputes [WTO DSU].

⁴⁴ Chang-Fa Lo, “Dispute settlement under free trade agreements: its interaction and relationship with WTO dispute settlement procedures”, in Y. Taniguchi, A. Yanovich, and J. Bohanes (eds), *The WTO in the Twenty-first Century: Dispute Settlement, Negotiations, and Regionalism in Asia*, 2007 (Cambridge: University Press), 467.

⁴⁵ Article 3(2) WTO DSU; see AB Report, *Mexico – Tax Measures on Soft Drinks and Other Beverages* (2006), WT/DS308/AB/R [*Mexico – Taxes on Soft Drinks*], ¶78.

⁴⁶ Panel Report, *US-Section 301-310 of the Trade Act 1974*, WT/DS152/R, 27 January 2000, ¶7.38-7.39.

⁴⁷ Panel Report, *Mexico – Tax Measures on Soft Drinks and Other Beverages* (2005), WT/DS308/R [*Mexico – Taxes on Soft Drinks*], ¶8.162.

⁴⁸ *Ibid*, ¶8.179, 8.195; see also, Antoni and Ewing-Chow, *supra* note 5, 343.

⁴⁹ *Ibid*, ¶8.180.

⁵⁰ *Ibid*, ¶8.181.

⁵¹ AB Report, *Mexico-Taxes on Soft Drinks*, *supra* note 45, ¶77.

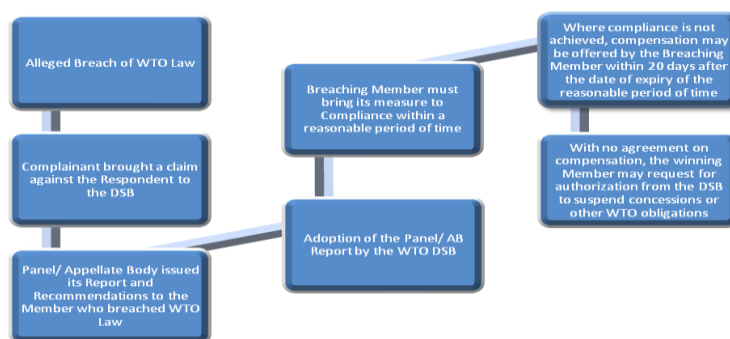
obligation and became adjudicators of non-WTO disputes, beyond the mandate under the DSU.⁵² Therefore, it was ruled that measures taken under Article XX (d) of the GATT does not include countermeasures.

The DSU does allow WTO Members to take trade countermeasures, but only after certain procedures have been done. The DSU obliges WTO Members to settle their dispute according to its rules and procedures.⁵³ When a Member (“Complainant”) alleges another Member (“Respondent”) violates its obligation under any of the WTO Agreements, the Complainant may bring a case against the Respondent to the WTO DSB and subsequently go through the various phases, including consultation, a panel proceeding, the Appellate Body (AB) proceeding (if there is an appeal),⁵⁴ and adoption of the panel report and/or the AB report.⁵⁵

The report contains panel and/or appellate body recommendations for the Member concerned to bring its measure into conformity with the WTO Agreement that it has violated, and possibly suggestions of ways for the Member to implement the recommendations.⁵⁶

In the event that the Member concerned cannot comply promptly with the recommendations and rulings of the DSB, the Member will be given a reasonable period of time to comply.⁵⁷ If there is disagreement as regards the measures taken to comply with the recommendations and rulings, such a dispute shall be resolved by a dispute settlement procedure which whenever possible by the original panel.⁵⁸ And if compliance is not achieved within the time period specified, the defaulting member can offer “compensation”, and this may have to be granted on a non-discriminatory basis to the winning party and all WTO Members,⁵⁹ either in the form of tariff reductions or increase in import quotas by the defaulting party. Although arguably this may be the least-trade distortive measure, it is rarely chosen by the infringing WTO Member.⁶⁰ If the disputing WTO Members cannot agree on a satisfactory compensation, the winning Member may take countermeasures by requesting for authorization from the DSB to suspend concessions or other obligations under WTO covered agreements.

Figure 1. Process to Resort to Countermeasures under the DSU



⁵² *Ibid*, ¶78.

⁵³ Article 23 DSU.

⁵⁴ *Ibid*, Article 17 (6).

⁵⁵ *Ibid*, Articles 16 and 17 (14).

⁵⁶ *Ibid*, Article 19(1).

⁵⁷ *Ibid*, Article 21 (3).

⁵⁸ *Ibid*, Article 21 (5).

⁵⁹ *Ibid*, Article 22.1.

⁶⁰ Michael Koebele, *World Trade Organization Enforcement System*, Max Planck Encyclopedia of Public International Law. Actual payment of compensation occurred once in *US—Section 110(5) Copyright Act* (2002), and paid only to the European Community.

B. Requirements for a Lawful Trade Countermeasure

Under the DSU, several requirements must be fulfilled for a state to implement countermeasures against other WTO Member.

1. Proper Subject

Article 22.3(a) DSU provides a general principle that the complaining WTO Member should first seek suspension of concessions or other obligations with respect to the same sector(s) as that in which the panel or the AB has found a violation or other nullification or impairment. For example, for a violation of tariff of health products, the complaining WTO Member must also suspend concessions on the sector of goods under the General Agreement on Tariff and Trade 1994 (GATT). Only when this is not practicable or not effective, Article 22.3 (b) DSU allows the complaining member to suspend concessions or other obligations in other sectors under the same agreement (cross-sector retaliation). If this is not practicable or effective, and the circumstances are serious enough, then Article 22.3 (c) DSU allows the member to suspend concessions or other obligations under another covered agreement (cross-agreement retaliation), for example the General Agreement on Trade in Services (GATS).

Table 1. Types of Countermeasures in the WTO

Case	Initial Violation	Approved Countermeasures			Status of Sanction
		Same sector	Same Agreement	Other Sector and agreements	
<i>US – Upland Cotton</i> ⁶¹	Subsidies on cotton (SCM Agreement)	Imposition of additional custom duties under Agreement on Trade in Goods (Annex 1A) on medical products, food, and arms.		<p><u>GATS</u></p> <p>Horizontal and/or sectoral concessions and obligations for all sectors in Brazil's schedule under the GATS, including: business services; communication services; construction and related engineering services; distribution services; financial services; tourism and travel-related services; and transport services.</p> <p>TRIPS: copyright and related rights; trademarks; industrial designs; patents; and protection of undisclosed information.</p>	Both parties concluded a mutual framework agreement to resolve the issue. The US provided certain payment to Brazil.
<i>Brazil – Aircraft</i> ⁶²	Subsidies on aircraft (SCM Agreement)	Suspension of tariff concession or other obligations under: the GATT; the Agreement on		-	Authorized by the DSB in the amount of \$1.4 billion (over

⁶¹ Panel and AB Reports, Decision of the Arbitrator (Art. 22.6 DSU), *United States – Subsidies on Upland Cotton*, (2004, 2005, 2009) WT/DS267/R and Corr.1, Add.1, Add.2 and Add.3, WT/DS267/AB/R, WT/DS267/ARB/2 [*US-Upland Cotton*].

		Textiles and Clothing; and the Agreement on Import Licensing Procedures.			6 years), but sanction did not go into force.
<i>US – Gambling</i> ⁶³	Limitations on market access in gambling and betting services those are not specified in its Schedule (Article XVI GATS)	Not practicable and may impair the limited entertainment options in Antigua. ⁶⁴	Not practicable due to the risk of economic disruption. ⁶⁵	TRIPS Agreement: copyright and related rights, trademarks, industrial designs, patents, and protection of undisclosed information. Neither specific mechanism nor specific obligations to be suspended were conveyed. ⁶⁶	DSB authorized Antigua to take countermeasures according to the Decision of Arbitrators, e.g. in respect of IP rights.
<i>EC – Hormones</i> ⁶⁷	Ban on imports of hormone treated beef (Article 5.1 of the Agreement on the Application of Sanitary and Phytosanitary Measures)	Suspension of concessions for import of goods, e.g. meat, pork meat, tomatoes. ⁶⁸ Or in general, Annex 1 Trade in Goods Agreement.		-	The US imposed retaliatory duties (100% <i>ad valorem</i>) on imports of some agricultural exports, including meat, poultry, cheese, etc., and manufactured goods, such as Italian scarves, hair clippers and motorcycles.
<i>EC – Bananas III (Ecuador)</i> ⁶⁹	Tariff quota reallocation (Art. XIII:1 GATT and the chapeau of Art. XIII:2 GATT) Export certificate requirement (Art. I:1 GATT) Import licensing procedures (Art. III:4 GATT and Art. II and XVIII GATS)	Suspension of tariff concessions under the GATT (not including investment goods or primary goods used as inputs in manufacturing and processing industries).		GATS with respect to wholesale trade services in the principal distribution services; TRIPS: Section 1, Article 14, Section 3 and Section 4.	The DSB authorized Ecuador to take countermeasures equivalent to US\$ 201,6 million. The case went through two compliance panels, and eventually the parties reached a mutually agreed solution in 2012.
<i>US – FSC</i> ⁷⁰	100% <i>ad valorem</i> charge on imports of certain goods from the US.	<i>Ad valorem</i> charge on imports of certain goods.			EC imposed additional customs duty of 5% on selected products, increased each month

⁶² Decision of the Arbitrators (Art. 22.6 DSU), *Brazil – Export Financing Programme for Aircraft* (Article 22.6 of the DSU), (2000) WT/DS46/ARB.

⁶³ Decision of the Arbitrators (Art. 22.6 DSU), *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, (2007) WT/DS285/ARB [US-Gambling].

⁶⁴ *Ibid*, ¶4.52.

⁶⁵ *Ibid*, ¶4.99.

⁶⁶ *Ibid*, ¶5.8-5.9.

⁶⁷ Decision of the Arbitrators (Art. 22.6 DSU), *European Communities – Measures Concerning Meat and Meat Products (Hormones)*, (1999) WT/DS26/ARB.

⁶⁸ *Ibid*, ¶80.

⁶⁹ Decision of the Arbitrators (Art. 22.6 DSU), *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, (2000) WT/DS27/ARB/ECU [EC-Bananas III (Ecuador)].

⁷⁰ Decision of the Arbitrator (Art. 22.6 DSU), *United States – Tax Treatment for “Foreign Sales Corporations”*, (2002) WT/DS108/ARB [US-FSC].

				by 1% up to a maximum of 17%. ⁷¹
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The arbitrators in *EC-Bananas III* and *US-Gambling* held that practicability in the provision referred to whether suspension in the same sector or agreement was “available for application in practice, as well as suited to action in a particular case”.⁷² They argued that if there was no real option or the option was not suited to be used in the circumstances, it would not be practicable. However, the arbitrator in *US-Upland Cotton* diverted from the approach and found that the formulation of Article 22.3 DSU barred a member from freely choosing the most effective sector or agreement to do its countermeasure.⁷³ It is noteworthy the approach in *US – Upland Cotton* in this matter is not found in the defence of countermeasures under CIL.

Based on the macro-analysis of the WTO cases above, apparently most of countermeasures taken were the imposition of additional duties that deviate from the existing schedule of the winning member. The other countermeasure was the suspension of obligations under the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) which may mostly affect developed countries.

Although none of the cases provide the exact type of countermeasure taken in the TRIPS,⁷⁴ one can assume the relevant suspended obligation would be pertaining to protection of intellectual property rights owned by nationals of the non-complying state. The arbitrators in *EC-Banana III (Ecuador)* shared their view regarding complications which may arise in countermeasures of TRIPS obligations. It took an example of Article 14 TRIPS regarding protection of rights of performers, producers of phonograms (sound recordings) and broadcasting organizations. The arbitrators noted that there might be different right holders of the different rights related to phonograms, and these holders might not necessarily all have the nationality of the one of the 13 member states in question.⁷⁵ However, Ecuador replied to this view by submitting that the suspension of concessions it proposed would be creating a licensing system to produce a sound recording.⁷⁶ The fact that the measure may affect the right of private holders of rights could raise a potential case in investment arbitration if the right holder registered its IP right in Ecuador, and the country has an investment agreement with the home country of the right holder.

2. Level of Countermeasure

Article 22.4 DSU requires the level of suspension of concessions (countermeasures) to be equivalent to the level of nullification or impairment. In practice, the level of suspension is limited to the harm suffered by the complaining member. Therefore, equivalent is fulfilled when the level is “equal to or below the level of nullification or impairment sustained”.⁷⁷ This requirement is somewhat similar to the requirement of proportionality in CIL. If the parties disagree on the level of countermeasures, the dispute may be sent to arbitration.⁷⁸ This arbitration mechanism provides an opportunity for the member who will be subject to countermeasures to ensure that such countermeasures are proportional before it is authorized and

⁷¹ Peter Van den Bossche, *The Law and Policy of the World Trade Organization: Text Cases and Materials*, 2nd Ed., 2008 (New York: Cambridge University Press), 228.

⁷² *EC-Bananas III (Ecuador)*, *supra* note 69, ¶70; *US Gambling*, *supra* note 63, ¶4.29.

⁷³ Decision of the Arbitrator (Art. 22.6 DSU), *US - Upland Cotton*, *supra* note 61, ¶5.78.

⁷⁴ Article 22.7 DSU provides that the arbitrator of Article 22.6 DSU shall not examine the nature of the concessions or other obligations to be suspended; *see also* Decision by the Arbitrators, *EC – Hormone Beef*, WT/DS26/ARB, ¶18.

⁷⁵ *EC-Bananas III (Ecuador)*, *supra* note 69, ¶144.

⁷⁶ *Ibid*, ¶161.

⁷⁷ Decision of the Arbitrators (Art. 22.6 DSU), *United States – 1916 Act [EC]*, (2004) WT/DS136/ARB, ¶5.21.

⁷⁸ Article 22.6 DSU.

carried out by the other Member. During the course of the arbitration, countermeasures should not be carried out. If this mechanism is not used, then it may indicate that the member concerned agrees to the level of the countermeasure.

3. Non-retroactive Remedies

Since the main objective of the WTO dispute settlement is “to secure the withdrawal of the measures” found illegal,⁷⁹ the remedies granted under the system is merely prospective⁸⁰ or limited to harm that occurs after a WTO Member fails to implement a panel or AB report within a reasonable period of time. This is clearly a deviation from CIL that allows for retroactive remedies, and that reparation must wipe out, as far as possible, all the consequences of the illegal act and re-establish the situation that would have existed if that act had not been committed.⁸¹

4. Prior Authorization from the DSB

Article 3(7) and Article 22(2) DSU provides that Members may take retaliatory measure of suspending the application of concessions or other obligations under the covered agreements on a discriminatory basis vis-à-vis the other Member, subject to authorization by the DSB. According to Article 22.6 DSU, the DSB (which consists of all WTO Members) are supposed to grant authorization for countermeasures within 30 days of the expiry of the reasonable period of time unless all members decided by consensus to reject the request (negative consensus rule).

C. Various Countermeasures in the WTO

1. Countermeasures as a Bargaining Chip (*US – Upland Cotton*)⁸²

In this case, the panel and the AB found that the US’ subsidies are inconsistent with some of the provisions in the Agreement on Subsidies and Countervailing Measures (SCM Agreement). However, the US failed to fully comply with the recommendations issued and rulings of the DSB, as confirmed by a compliance panel and the AB.⁸³

Subsequently, Brazil requested for authorization from the DSB to suspend concessions or other obligations under the Agreement on Trade in Goods in Annex 1A by imposing additional customs duties on a list of products imported from the US. In the event the amount of impairment exceeds a threshold described in the decision, Brazil requested authorization to suspend certain obligations under the TRIPS and the GATS. The US objected to the proposed measure, and the DSB referred the matter to arbitration under Article 22.6 DSU.

The arbitrators assessed the level of the proposed countermeasures and referred to the ILC Articles in interpreting the term.⁸⁴ In calculating the “appropriate” countermeasures, the arbitrators used the ‘amount

⁷⁹ *Ibid*, Articles 3.7 and 19.1.

⁸⁰ Panel Report, *United States – Import Measures on Certain Products from the European Communities*, (2000) WT/DS165/R, ¶6.106.

⁸¹ Permanent Court of Arbitration, *Chorzow Factory Case* (Ger. V. Pol.), (1928) P.C.I.J., Sr. A, No.17, at 47 (September 13) [Chorzow Factory]; International Court of Justice, *Military and Paramilitary Activities in and against Nicaragua* (Nicaragua v. U.S.), Merits 1986 ICJ Report, 14, 114 (June 27); *Reparations for Injuries Suffered in the Service of the United Nations*, Advisory Opinion, I.C.J. Reports 1949, 184.

⁸² *US-Upland Cotton*, Status of the Proceedings, available at http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds267_e.htm.

⁸³ AB Report, *US – Upland Cotton*, *supra* note 61, ¶448-449.

⁸⁴ Decision of the Arbitrators, *US – Upland Cotton*, *supra* note 61, ¶4.34-4.43.

of the subsidy' as the basis for the calculation.⁸⁵ Finally, it determined that Brazil may request authorization from the DSB to suspend concessions or other obligations under the Agreements on Trade in Goods Annex 1A, at a level not exceeding USD 147.4 million for 2006, and additionally, the amount can be increased according to the change in Brazil's total imports from the US. Furthermore, Brazil may also suspend certain obligation under the TRIPs and the GATS.⁸⁶

In November 2009, the DSB eventually authorized Brazil's proposed countermeasures. Although in March 2010, Brazil notified the DSB that it would increase import duties on certain products from the US, it eventually postponed the imposition of the countermeasures because both eventually concluded a Framework for a Mutually Agreed Solution to the Cotton Dispute. Under the Framework Agreement, the US agreed to make payments as compensation to a Cotton Fund for technical assistance and capacity building related to the Brazilian cotton sector.⁸⁷ This reflects an example where countermeasures is being used effectively as a bargaining chip to offset the impacts caused by breach of international obligation.

2. Traditional Implementation of Countermeasures (*US-FSC*)⁸⁸

The EC brought a case against Section 921-927 of the US Internal Revenue Code and related measures that establish special tax treatment for Foreign Sales Corporation (FSC). The AB upheld the panel's finding that the measure constituted a prohibited subsidy under Article 3.1(a) of the SCM Agreement. It also found that the measure violated Article 10.1 and 8 of the Agreement on Agriculture (AoA). The matter was then brought to a compliance panel, and it was found that the US still acted inconsistently with its obligations under the SCM Agreement, the AoA, and the GATT 1994 through its FSC amended legislation.

Subsequently, the EC requested the DSB's authorization to take countermeasures. The US requested the matter to be referred to arbitration pursuant to Article 22.6 DSU. The arbitrator determined that the EC's countermeasures in the form of the imposition of a 100% *ad valorem* charge on imports of certain goods from the US would be appropriate countermeasures. Accordingly, the EC requested authorization from the DSB to take countermeasures, and the request was granted.

3. Countermeasures as a Symbolic Act of Protest (*US-Gambling*)

Antigua and Barbuda brought claims against the US for its measures which affected the cross-border supply of gambling and betting services by Antigua. Before the panel, it argued the measures to be inconsistent with the US' obligations under the GATS. The panel found that US' measures were in violation of Article XVI:1 and XVI:2 of the GATS.⁸⁹ The AB upheld this particular finding.⁹⁰

Antigua was not satisfied by the US' compliance measures and requested for the establishment of a panel under Article 21.5 of the DSU. The panel concluded that the US had failed to comply with the recommendations and rulings of the DSB,⁹¹ and the DSB adopted this report. Antigua and Barbuda then requested authorization from the DSB to suspend concessions and related obligations under the GATS

⁸⁵ *Ibid*, ¶4.132-137; Decision of the Arbitrators (Art. 22.6 DSU), *Canada — Export Credits and Loan Guarantees for Regional Aircraft (Canada)*, (2003) WT/DS222/ARB, ¶3.60.

⁸⁶ Decision of the Arbitrators, *US - Upland Cotton*, *supra* note 61, ¶6.1-6.5.

⁸⁷ Statement by Brazil, DSB Meeting, 23 October 2012, available at http://www.cotton.org/issues/2012/upload/BrazilStatement_WTODSB-5.pdf.

⁸⁸ One-page summary of key findings of the dispute, *US-FSC*, available at http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds108_e.htm.

⁸⁹ Panel Report, *US - Gambling*, (2004) WT/DS285/R, ¶7.2 (b).

⁹⁰ AB Report, *US - Gambling*, (2005) WT/DS285/AB/R, ¶373(A).

⁹¹ Article 21.5 Panel Report, *US - Gambling*, (2007) WT/DS285/RW, ¶7.1.

and the TRIPS Agreement to the US. However, the US objected to the level of suspensions of concessions and obligations, and provided alternative countermeasures. Subsequently, the DSB referred the matter to arbitration under Article 22.6 DSU. The arbitrators found the US' identification of the existence of alternative possible means of compliance other than that envisaged by Antigua would not be sufficient to object Antigua's proposed suspension.⁹² The arbitrators determined that Antigua may request authorization from the DSB to suspend obligations under the TRIPS Agreement.⁹³ In January 2013 (6 years after the arbitrator's decision), Antigua and Barbuda requested the DSB to authorize the suspension of concessions and obligations to the US with regard to intellectual property rights, and the DSB granted the authorization. Antigua then announced in July 2013 the formation of a select committee charged with overseeing the implementation process of the countermeasures relating to IP rights.⁹⁴ This case reflects that countermeasures could be used simply as a symbolic act of protest, where further implementation of the measure is not really taken, or with the recent development, delayed for a long period.

Apparently, within the WTO regime itself, the potential issue of DSB-authorized countermeasures interfering with private rights of investor has been recognized for a while, particularly in the discussions of the arbitrators under Art. 22.6 DSU of *EC-Banana III (Ecuador)*. The discussion recognizes that countermeasures of the GATS would affect service suppliers who are commercially present in the territory of the state taking countermeasures and could lead to conflicts with rights to, e.g. equal treatment embodied in national legislation or international treaties.⁹⁵ Similarly, countermeasures under the TRIPS may interfere with private rights owned by natural or legal persons. While there is an awareness of the problem, the arbitrators in the case left the resolution of the problem entirely to the prerogatives of the Member implementing the countermeasures.⁹⁶ This in itself does not resolve the problems that may arise from legitimate trade countermeasures, as we could see further below.

IV. Countermeasures in International Investment Law

In International Investment Law, the defence of countermeasures is rarely mentioned explicitly in investment treaties. There have not been many cases dealing with this notion. Perhaps, one of the reasons behind the rarity is because host states often do not put forth this defence. Nevertheless, there are several cases that may provide some guidance on how arbitral tribunals view this defence.⁹⁷ It is noted that all the cases arise from NAFTA Chapter 11. However, we will try to apply our further analysis on the issue to other BITs, by adjusting to the relevant text of the BITs.

The most prominent cases are those arising from a set of strikingly similar facts in the Sugar War between Mexico and the US, dealing with the imposition of tax on beverages containing high-fructose corn syrup (HFCS) by Mexico. Despite the similar set of facts, the tribunals have different analysis as elaborated below.

⁹² Decision of the Arbitrators, *US Gambling*, *supra* note 63, ¶3.23.

⁹³ Decision of the Arbitrator, *US – Gambling*, *supra* note 63, ¶6.1.

⁹⁴ Official Website of the Government of Antigua and Barbuda, *Antiguan Government Announces Formation of WTO Remedies*, http://www.ab.gov.ag/article_details.php?id=4294&category=38.

⁹⁵ *EC-Bananas III (Ecuador)*, *supra* note 69, ¶112-113.

⁹⁶ *Ibid*, ¶157-158.

⁹⁷ *ADM v. Mexico*, *supra* note 2; *Corn Products International, Inc. v. Mexico*, ICSID ARB(AF)/04/1, Award, 15 January 2008 [*Corn Products v. Mexico*]; *Cargill, Inc. v. Mexico*, ICSID ARB(AF)/05/2, Award, 18 September 2009 [*Cargill v. Mexico*].

A. *The Facts of the US – Mexico Sugar War*

This Sugar War involved three dispute settlement forums, the WTO DSB (two different cases),⁹⁸ Chapter 19 NAFTA tribunal⁹⁹ and investor-state arbitration tribunals. The underlying reason of the dispute was the disagreement between Mexico and the US on the American sugar import quotas allocated to Mexico under the North American Free Trade Agreement (NAFTA).

During the NAFTA negotiation, due to the inefficiency of its sugar industry, Mexico did not have a net production surplus of sugar. However, this changed not long after. After the entry into force of NAFTA in 1994, Mexico sought to export a substantial additional quantity of sugar to the US, above the quotas allocated to it during the negotiations. Apparently, the US market for export of sugar turned out to be not as opened as Mexico expected, and at the same time the imports of HFCS from the US into Mexico increased.¹⁰⁰ This effectively reduced the domestic market demand for Mexican sugar and increased Mexico's sugar surplus.

In order to clarify the uncertainties created by the 1993 Exchange of Letters between the countries regarding the quota, Mexico tried to resort to the dispute settlement mechanism established in Chapter 20 of NAFTA. However, at the panel-establishment stage, it was found that the roster of panel of the US had not been formally established, and the US refused to cooperate in the composition of the panel.¹⁰¹

Failing to settle the dispute through NAFTA, Mexico initiated an antidumping investigation of American exports of HFCS to Mexico and decided to impose provisional duties in 1997 and definitive duties in 1998. The US successfully challenged these duties before NAFTA¹⁰² and the WTO, and Mexico was obliged to withdraw the duties.¹⁰³

In 2002, the Mexican Congress, stating that it was “committed to protecting the domestic sugar industry”,¹⁰⁴ introduced a series of measures to “stop the displacement of domestic cane sugar by imported HFCS and soft drinks and syrup sweetened with HFCS:¹⁰⁵ (1) a 20 per cent tax on the transfer and importation of soft drinks using any sweetener other than cane sugar (soft drinks tax); (2) a 20 per cent tax on the commissioning, mediation, agency, representation, brokerage, consignment and distribution of soft drinks using any sweetener other than cane sugar (distribution tax); and (3) a number of bookkeeping requirements on taxpayers subject to the soft drink tax and the distribution tax.

⁹⁸ Panel Report, *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup from the United States* (2000), WT/DS132/R [*Mexico – Corn Syrup*]; Panel and Appellate Body Reports, *Mexico - Taxes on Soft Drinks*, *supra* note 45.

⁹⁹ *Review of the Final Determination of the Antidumping Investigation on Imports of High Fructose Corn Syrup, Originating from the United States of America* (2001), MEX-USA-98-1904-01 [*Antidumping Determination on HFCS*].

¹⁰⁰ United States Department of Agriculture, Foreign Agriculture Service, *Mexico and Sugar: Historical Perspective* available at <http://www.fas.usda.gov/htp/sugar/2004/History%20of%20sugar%20dispute%20final.pdf>, HFCS is an alternative sweetener produced from corn starch slurry, widely used in the beverage industry as a sugar substitute.

¹⁰¹ Antoni and Ewing-Chow, *supra* note 5, 327.

¹⁰² *Antidumping Determination on HFCS*, *supra* note 99.

¹⁰³ Panel Report, *Mexico – Corn Syrup*, *supra* note 47.

¹⁰⁴ *ADM v. Mexico*, *supra* note 2, ¶80.

¹⁰⁵ Mexico's first written submission, *Mexico – Taxes on Soft Drinks*, ¶111.

The measures were challenged before the WTO.¹⁰⁶ Additionally, a number of American investors in Mexico also filed investment disputes against Mexico under the investor-state dispute settlement mechanism established in NAFTA Chapter 11.

The trade dispute between the US and Mexico was eventually resolved in 2006 when they agreed to achieve free trade in HFCS by 2008. As part of this agreement, the Mexican measures were repealed as of 2007.¹⁰⁷ However, the investor-state claims continued as investors continued to seek damages for their losses during the period when the measures were in place. In the arbitration proceedings, Mexico sought to justify its measures by claiming that they constitute legitimate countermeasures against the US for the latter's violation of NAFTA Chapter 7 and Chapter 20 obligations.¹⁰⁸

B. Contextualizing the NAFTA Dispute Settlement Bodies

Under the NAFTA framework, members can request for the establishment of a tribunal or a panel under different chapters, and in analyzing notion of countermeasures in investment law, it is useful to look at Chapter 11 and Chapter 20.

As regards the competence of a panel established under Chapter 20, Article 2004 provides:

“Except for the matters covered in Chapter Nineteen (Review and Dispute Settlement in Antidumping and Countervailing Duty Matters) and as otherwise provided in this Agreement, the dispute settlement provisions of this Chapter shall apply with respect to the avoidance or settlement of all disputes between the Parties regarding the interpretation or application of this Agreement or wherever a Party considers that an actual or proposed measure of another Party is or would be inconsistent with the obligations of this Agreement or cause nullification or impairment in the sense of Annex 2004.”

It can be seen that a panel established under Chapter 20 has wider competence compared to Chapter 11. It is presumed that the panel cannot address disputes arising from Chapter 11 which explicitly provides its own dispute settlement mechanism.

With regard to countermeasures, Chapter 20 specifically regulates this possibility in Article 2019 NAFTA, i.e. non-implementation – suspension of benefits. To a certain extent, countermeasures under this provision are similar to that of the WTO DSU. It can be taken only after there is a finding of inconsistency with the obligations of NAFTA. There is no requirement to obtain an authorization to take the countermeasure, but if one of the disputing parties disagrees to the level of the countermeasure, the Free Trade Commission may establish a panel to determine whether the level of the countermeasure is manifestly excessive. In a way, there remains a check and balance mechanism to ensure that countermeasure is not taken abusively.

Articles 1116 and 1117 provide that the competence of a tribunal established under Chapter 11 include breach of an obligation under Section A or Article 1503(2) (state enterprises), or Article 1503(3)(a) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A.

¹⁰⁶ Panel and Appellate Body Reports, *Mexico – Taxes on Soft Drinks*, *supra* note 45 and 47.

¹⁰⁷ *ADM v. Mexico*, *supra* note 2, ¶97; *Cargill v. Mexico*, *supra* note 97, ¶124.

¹⁰⁸ *ADM v. Mexico*, *supra* note 2, ¶110; *Cargill v. Mexico*, *supra* note 97, ¶379; *Corn Products v. Mexico*, *supra* note 97, ¶144.

It is important to understand the basic competence of each tribunal or panel for our further analysis on the defence of countermeasures as raised by Mexico in the investor-state arbitration cases.

C. Countermeasures Analysis by Investor-State Arbitration Tribunals

This parts seeks to highlight the different approaches adopted by each tribunal in the three cases involving Mexico due to its tax measures on soft drinks (claimed countermeasures) taken in response to the alleged breach of the US' obligations under NAFTA. The award was issued in the following order, *ADM v. Mexico* (2007), *Corn Products v. Mexico* (2008), and *Cargill v. Mexico* (2009). Only the tribunal in *Cargill v. Mexico* actually considered the previous award of *ADM v. Mexico*.

In analyzing the decisions of the tribunals, we will assess them in the following order 1) the defence if the defence of countermeasures is available under NAFTA Chapter 11, 2) whether arbitration tribunals have the jurisdiction to assess the defence, and 3) the criteria of countermeasures. It is noteworthy, in the two cases, the tribunals seemed to conflate all the issues.

1. Availability of the defence of Countermeasures under NAFTA Chapter 11

In assessing whether the defence is available under NAFTA Chapter 11, one can assess: 1) whether it is provided explicitly in the Chapter, and 2) whether it is provided in NAFTA. Chapter 11 does not explicitly provide the defence of countermeasures, and in all three cases Mexico argued that the defence arises from CIL.¹⁰⁹ At the same time, if one looks NAFTA as a whole, the agreement does provide the possibility of state parties to take countermeasures. Therefore, this part will assess both types and how they fit into Chapter 11 according to the arbitration tribunals.

a. Countermeasures under CIL

All tribunals dealt with the question of whether a state can raise this defence for breach of its NAFTA Chapter 11 obligations. In *Corn Products v. Mexico* and *Cargill v. Mexico*, this issue was addressed early on, and both found that countermeasures could not be applied under Chapter 11 to preclude wrongfulness.¹¹⁰

The tribunal in *ADM v. Mexico* found that although not explicitly provided in Chapter 11, the defence of countermeasures is available by incorporation from CIL. It opined that since Chapter 11 did not specifically prohibit the use of countermeasures, the question about the availability of the defence was a question of CIL.¹¹¹

The other tribunals disagreed to this finding. In *Corn Products v. Mexico*, the tribunal found that “there is no room for a defence based upon the alleged wrongdoing not of the claimant but of its State of nationality, which is not a party to the proceedings.”¹¹² It supported this argument with lengthy discussion regarding the nature of rights and obligations which arise under Chapter 11, as discussed further below. Similarly, the tribunal in *Cargill v. Mexico*, through its discussion on the nature of rights of investors under Chapter 11 decided that countermeasures cannot preclude the wrongfulness of claims under Chapter 11.¹¹³

¹⁰⁹ *ADM v. Mexico*, *supra* note 2, ¶110; *Cargill v. Mexico*, ¶379.

¹¹⁰ *Corn Products v. Mexico*, *supra* note 97, ¶191; *Cargill v. Mexico*, *supra* note 97, ¶430.

¹¹¹ *ADM v. Mexico*, *supra* note 2, ¶120.

¹¹² *Corn Products v. Mexico*, *supra* note 97, ¶161.

¹¹³ *Cargill v. Mexico*, *supra* note 97, ¶429.

Simply, the tribunals' analyses lead us to the assessment of the rights under NAFTA Chapter 11. This is particularly important because under CIL, it is recognized that countermeasures may not preclude wrongfulness against third parties, especially if they have individual rights.¹¹⁴

In *ADM v. Mexico*, this issue was addressed in one of the requirements for a legitimate countermeasure, namely non-impairment of individual substantive rights of claimants. The source of this requirement is rather unclear even though it was claimed by the tribunal to be derived from CIL.¹¹⁵ However, the requirement is neither present in *Gabchikovo-Nagymaros* nor the ILC Articles.¹¹⁶ The tribunal examined whether NAFTA Chapter 11 provides a self-contained mechanism endorsing substantive and procedural rights for qualified investors, and whether such rights are independent from the rights of the Member States.¹¹⁷

For this evaluation, the tribunal considered three theories: 1) the traditional derivative theory—“when investors trigger arbitration proceedings against a State, they are in reality stepping into the shoes and asserting the rights of their home State”, 2) an intermediate theory—“investors are vested only with an exceptional procedural right to claim state responsibility under Section B before an international arbitral tribunal,” and 3) a direct theory – “there are two distinct legal relationships under an investment treaty: the investor and the host State on one hand, and the State Parties on the other hand”.¹¹⁸ The tribunal adopted the intermediate theory,¹¹⁹ and Mexico supported this by citing NAFTA jurisprudence, scholarly writings and the position of the Member States in their intervention in other NAFTA Chapter 11 proceedings.¹²⁰ Specifically, the tribunal in *Loewen Group, Inc. & Raymond v. United States of America*¹²¹ opined that Chapter 11 provides what in origin are the rights of the Member States regarding the treatment of their national's investment. The specific word of the tribunal was, “claimants are permitted for convenience to enforce what are in origin the rights of Party states.”¹²² This demonstrated that the claimants do not have the right on their own.

The intermediate theory was viewed as one that respected the traditional structure of international law and the object and purpose of Chapter 11.¹²³ The tribunal viewed Section A of Chapter 11 as substantive obligations which were inter-state instead of accruing individual rights.¹²⁴ It opined that the proper interpretation of the NAFTA would not lead to the approach where investors are granted individual rights. It distinguished the structure of NAFTA Chapter 11 and human right treaties. The former only granted a procedural right of action under Section B of Chapter 11—that would not otherwise exist under international law—and simply complemented the promotion and protection of aliens under CIL.¹²⁵ The tribunal also mentioned that the right under this section was “to invoke the responsibility of the host state in an international arbitration, according to the promotion and protection standards addressed in Section A, [and]... all customary international law rules not covered by the *lex specialis* under Chapter Eleven”

¹¹⁴ Article 49 ILC Articles.

¹¹⁵ *ADM v. Mexico*, *supra* note 2, ¶133.

¹¹⁶ *Ibid*, ¶126.

¹¹⁷ *Ibid*, ¶161.

¹¹⁸ *Ibid*, ¶166.

¹¹⁹ *Ibid*, ¶163.

¹²⁰ *Ibid*, ¶167.

¹²¹ *Loewen Group, Inc. & Raymond v. United States of America*, ICSID Case No. ARB (AF)/ 98/3, Award, 26 June 2003 [*Loewen v. US*].

¹²² *Ibid*, ¶233.

¹²³ *ADM v. Mexico*, *supra* note 2, ¶168.

¹²⁴ *Ibid*, ¶168.

¹²⁵ *Ibid*, ¶171, 173.

(emphasis added).¹²⁶ With this theory, since individuals do not have rights under NAFTA, the defense of countermeasures may preclude wrongfulness of violations under Chapter 11.

In *Corn Products v. Mexico*, a different analysis emerged. Citing the commentary to Article 49 ILC Articles, the tribunal highlighted that a countermeasure cannot affect the rights of a party other than the State responsible for the prior breach.¹²⁷ The tribunal found that under Chapter 11, an investor has rights of its own, distinct from those of the State of its nationality.¹²⁸ The tribunal mentioned that individuals and corporations may possess rights under international law. It implied that since Chapter 11 conferred procedural rights upon investors, the parties would have intended to confer substantive rights directly upon investors. Otherwise, a procedural right to institute proceedings to enforce rights which were not theirs would be counterintuitive.¹²⁹

The tribunal argued that even in the notion of diplomatic protection, individuals actually have their own rights. First, the local remedies rule actually requires individuals to pursue their own rights before the state can do so.¹³⁰ Second, the doctrine of continuing nationality requires the nationality of the individual of whom a state is bringing a claim of diplomatic protection to be the nationality of that state at the date of the alleged wrong until the date of the award. If an injury to the national is a violation of the rights of the state, the victim's nationality after the date of the injury should not have been relevant.¹³¹ Accordingly, the tribunal concluded that a state claiming for a wrong done to its national would in reality act on behalf of the national, rather than assert a right of its own.¹³²

The tribunal opined that the fiction in the notion of diplomatic protection did not need to continue in a case in which the individual had the right to bring its own claim. It claimed that the state of nationality did not control the conduct of the case, nor received any payment of compensation.¹³³ The tribunal contested Mexico's argument from the case of *Loewen*, and simply said that the tribunal in that case dealt with a far more restricted point. Unfortunately the tribunal did not explain further what it meant.¹³⁴ It cited *Republic of Ecuador v. Occidental Exploration and Production Co* whereby the Court of Appeal for England and Wales found that investors under both the NAFTA and bilateral investment treaties were asserting rights of their own rather than exercising a mere procedural power to enforce the rights of their State.¹³⁵

The tribunal in *Corn Products v. Mexico* concluded that since investors had rights of their own under NAFTA Chapter 11, a countermeasure could not deprive their rights.¹³⁶ It distinguished the case with the case of *US-France Air Services* in which the proceeding involved two states and concerned the rights of the two States, instead of the rights of the airlines.¹³⁷

Similarly, the tribunal in *Cargill v. Mexico* also believed that it would be a fiction to say that investors' rights under NAFTA Chapter 11 are the rights of the state.¹³⁸ *Cargill* also cited *Occidental v.*

¹²⁶ *Ibid*, ¶174.

¹²⁷ *Corn Products v. Mexico*, *supra* note 97, ¶164.

¹²⁸ *Ibid*, ¶165.

¹²⁹ *Ibid*, ¶169.

¹³⁰ *Ibid*, ¶171.

¹³¹ *Ibid*, ¶172.

¹³² *Ibid*, ¶173.

¹³³ *Ibid*, ¶173.

¹³⁴ *Ibid*, ¶175.

¹³⁵ *Ibid*, fn 72, citing *Republic of Ecuador v. Occidental Exploration and Production Co* [2005] EWCA Civ 1116, [2006] QB 432 [*Occidental v. Ecuador*], ¶14.22.

¹³⁶ *Ibid*, ¶176.

¹³⁷ *Ibid*, ¶177-178.

¹³⁸ *Cargill v. Mexico*, *supra* note 97, ¶386.

Ecuador decision in which the English Court of Appeal found that it was artificial and wrong in principle to suggest that the investor pursued a claim vested in his or its home state.¹³⁹ The tribunal strongly opined that investors had independent rights under Chapter 11.¹⁴⁰ The tribunal found that although a countermeasure defence that was raised in a setting of diplomatic protection proceeding would preclude the wrongfulness of the act that would have entailed State responsibility,¹⁴¹ the same defence may not have such effect in NAFTA Chapter 11 proceeding which allows individuals to submit a claim.¹⁴²

Although the tribunal agreed that the rights of investors under Chapter 11 was derived from the agreement of the State Parties, and may be dependent on the continuation of that agreement, it drew an analogy to rights of individuals within municipal legal system where the origin of such rights may be found in the act of a sovereign, but eventually did not negate the existence of such rights conferred. Further, the tribunal refused the classification of procedural and substantive rights. For the tribunal, what matters is the fact that the investor institutes the claim, calls a tribunal into existence, and is the named party in the proceedings and award.¹⁴³

It is clear from the three cases above that the nature of rights under Chapter 11 will be critical to determine the availability of the defence of countermeasures under CIL. Two of them believed that Chapter 11 provides individual rights, and this is the critical finding that leads to the tension between the regimes of trade and investment.

b. Countermeasures under NAFTA Chapter 20

As a matter of treaty interpretation of looking at the context of a treaty, it is also important to see the general framework of NAFTA as a Free Trade Agreement providing the right to countermeasures under Article 2019 NAFTA. This issue of countermeasures under Chapter 20 was raised both by the claimants and Mexico in different occasions of *ADM v. Mexico* and *Cargill v. Mexico*.

In *ADM v. Mexico*, claimants argued that the right to countermeasures under CIL for violations of NAFTA provisions had been waived by NAFTA Parties because NAFTA was *lex specialis*.¹⁴⁴ NAFTA regulates the existence of an internationally wrongful act under the FTA and its legal consequences, as well as its own dispute settlement mechanism under NAFTA Chapter 19 and 20.¹⁴⁵

Admittedly, NAFTA Chapter 20 regulates countermeasures that can be taken only in a situation of non-compliance with a decision rendered in a Chapter 20 State-to-State arbitration.¹⁴⁶ Mexico did not raise the defence of countermeasures under this chapter because there had been no panel decision under Chapter 20.¹⁴⁷ Mexico responded to the *lex specialis* argument by saying that a party “cannot be bound by a *lex specialis* that has proved impossible to invoke”,¹⁴⁸ referring to the refusal of the US to cooperate in the composition of a panel under NAFTA Chapter 20. This position arguably has its legal basis in Article 52 (4) ILC Articles which provides that the *lex specialis* rule does not apply if the breaching state failed to

¹³⁹ *Occidental v. Ecuador*, *supra* note 135, ¶17.

¹⁴⁰ *Cargill v. Mexico*, *supra* note 97, ¶387, 426.

¹⁴¹ *Ibid*, ¶424.

¹⁴² *Ibid*, ¶425.

¹⁴³ *Ibid*, ¶426.

¹⁴⁴ Article 51 ILC Articles.

¹⁴⁵ *ADM v. Mexico*, *supra* note 2, ¶113-114; see also *Cargill v. Mexico*, *supra* note 97, ¶395-396.

¹⁴⁶ This was also acknowledged by the tribunal in *ADM v. Mexico*, *supra* note 2, ¶122, but it considered that the default regime under CIL applied to the situation in the case (presumably the tribunal referred to Chapter 11).

¹⁴⁷ *Ibid*, ¶115.

¹⁴⁸ *Ibid*, ¶115; *Cargill v. Mexico*, *supra* note 97, ¶397, 400-401.

implement the dispute settlement procedures in good faith. However, Mexico had to demonstrate the lack of good faith, among others by repetitive request to the US for the establishment of such a panel.

Unfortunately, this argument was never addressed by the tribunal in *ADM v. Mexico*. The tribunal simply found that the claimants' argument oversimplified the application of *lex specialis* and in fact elaborated that Section A of Chapter 11 is a form of *lex specialis*,¹⁴⁹ but CIL should continue to govern all matters not covered by Chapter 11.¹⁵⁰ With this, the tribunal got away from addressing the relationship between countermeasures under Chapter 20 and obligations under Chapter 11.

In *Cargill v. Mexico*, Mexico raised the concern regarding this matter when the tribunal assessed the nature of rights of investors under Chapter 11. The tribunal believed that investors had rights, but considered it unfruitful to characterize them as substantive or merely procedural.¹⁵¹ Mexico challenged this argument arguing that such conception would undermine Article 2019 of the NAFTA that allows a party to take countermeasures, and in general could constrain states' basic rights under international law, and endow investors with greater rights than States.¹⁵² The tribunal noted Mexico's argument but opined that this issue could be addressed by that fact that there is always a range of possible countermeasures to be adopted that may not affect investors.¹⁵³ However, it failed to elaborate the types of countermeasures that would be available, especially in the closely related area of trade and investment.

We believe that the tribunal should take into account the whole structure of NAFTA in order to interpret Chapter 11 and the nature or rights or obligations given therein,¹⁵⁴ including Chapter 20. This is supported by Article 1115 NAFTA which provides, "Without prejudice to the rights and obligations of the Parties under Chapter Twenty (Institutional Arrangements and Dispute Settlement Procedures), this Section establishes a mechanism for the settlement of investment disputes..." This also goes to Article 1112 NAFTA providing where there is inconsistency between the Chapter with another NAFTA Chapter, the other Chapter shall prevail. If these were taken into account, the tribunal should have come into conclusion that NAFTA Chapter 20 countermeasures may preclude wrongfulness under NAFTA Chapter 11. Otherwise, there would be ongoing tension in the agreement itself. If trade countermeasures under NAFTA could preclude wrongfulness under Chapter 11, logically, other trade countermeasures incorporated by CIL should have the same effect on IIAs.

2. Jurisdiction over the Defence of Countermeasures

Although only the tribunal of *ADM v. Mexico* who ruled having jurisdiction to assess the defence, the other two tribunals also addressed this matter to a certain extent.

In *ADM v. Mexico*, the tribunal immediately found it had the jurisdiction as the defence of countermeasures was raised from CIL¹⁵⁵ against the alleged violation of obligations under Chapter 11.¹⁵⁶ Although the claimants argued that the right to countermeasures under CIL for violations of NAFTA provisions had been waived by NAFTA Parties because NAFTA was *lex specialis*,¹⁵⁷ the tribunal found that the claimants' argument oversimplified the application of *lex specialis* and in fact elaborated that

¹⁴⁹ *Ibid*, ¶117.

¹⁵⁰ *Ibid*, ¶119.

¹⁵¹ *Cargill v. Mexico*, *supra* note 97, ¶426.

¹⁵² *Ibid*, ¶391-392.

¹⁵³ *Ibid*, ¶428.

¹⁵⁴ Article 31 (1) VCLT 1969.

¹⁵⁵ *See* Article 1131 (1) NAFTA.

¹⁵⁶ *ADM v. Mexico*, *supra* note 2, ¶111.

¹⁵⁷ *Ibid*, ¶113-114; *see also Cargill v. Mexico*, *supra* note 97, ¶395-396.

Section A of Chapter 11 is in itself a form of *lex specialis*.¹⁵⁸ Even so, CIL should continue to govern all matters not covered by Chapter 11.¹⁵⁹ Since Chapter 11 did not specifically prohibit the use of countermeasures, the question about the availability of the defence was a question of CIL.¹⁶⁰ The tribunal ruled that it could constitute a legitimate defence against a breach under the Chapter as long as the Respondent proved that the measure met all conditions required.¹⁶¹

This issue of *lex specialis* may not arise when the defence of countermeasures is raised in an investor-state arbitration arising from a BIT because no BIT or investment agreement actually regulates the defence, thus by default they refer to rules in CIL.

Cargill also raised a similar argument of *lex specialis* to challenge the tribunal's jurisdiction.¹⁶² Although the tribunal found that the defence of countermeasure was not available under Chapter 11, it still claimed to have jurisdiction over the defence.¹⁶³

In contrast to the claimants in the two previous arbitrations, Corn Products International (CPI) argued that Mexico could not rely upon the countermeasures because it had been brought before the WTO panel and the AB under Article XX (d) GATT 1994,¹⁶⁴ and they had rejected it.¹⁶⁵ The tribunal rejected CPI's argument because even the AB did not consider the tax could amount to a countermeasure,¹⁶⁶ and the fact that it might violate Article III:4 GATT 1994 would not prevent the countermeasures from precluding wrongfulness in respect of obligations under other international agreements of CIL.¹⁶⁷

Despite refusing or acknowledging the existence of the defence of countermeasures under CIL, the tribunals in *ADM v. Mexico* and *Corn Products v. Mexico* assessed whether they had jurisdiction over one of the requirements of a legitimate countermeasure — the existence of breach of international obligation. The tribunals in *ADM v. Mexico* and *Corn Products v. Mexico* found that they had no jurisdiction over this question.¹⁶⁸ Despite the lack of jurisdiction over this requirement, the *ADM v. Mexico* tribunal proceeded to assess other requirements of a valid countermeasure over which it had jurisdiction, and mentioned that if Mexico fulfilled the other requirements, it would consider Mexico's request for a stay of the proceedings until a Chapter 20 procedure was completed.¹⁶⁹

In *Corn Products v. Mexico*, it was not clear whether this criterion of initial breach requires the existence of a ruling from a tribunal prior to the taking of the countermeasure.¹⁷⁰ Mexico argued that a "genuine belief" of the existence of a breach of international law was sufficient,¹⁷¹ and there was no need to establish the breach.¹⁷² The tribunal avoided addressing this question by concluding that the doctrine of

¹⁵⁸ *Ibid.*, ¶117.

¹⁵⁹ *Ibid.*, ¶119.

¹⁶⁰ *Ibid.*, ¶120.

¹⁶¹ *Ibid.*, ¶121.

¹⁶² *Cargill v. Mexico*, *supra* note 97, ¶395-396.

¹⁶³ *Ibid.*, ¶430.

¹⁶⁴ *Corn Products v. Mexico*, *supra* note 97, ¶152.

¹⁶⁵ AB Report, *Mexico-Tax Measures on Soft Drink*, *supra* note 45, ¶75.

¹⁶⁶ *Corn Products v. Mexico*, *supra* note 97, ¶156.

¹⁶⁷ *Ibid.*, ¶159.

¹⁶⁸ *ADM v. Mexico*, *supra* note 2, ¶131; *Corn Products v. Mexico*, *supra* note 97, ¶182.

¹⁶⁹ *ADM v. Mexico*, *supra* note 2, ¶133.

¹⁷⁰ *Corn Products v. Mexico*, *supra* note 97, ¶186-188, 190-191.

¹⁷¹ *Air Services Arbitration*, *supra* note 29, ¶81.

¹⁷² *Corn Products v. Mexico*, *supra* note 97, ¶184.

countermeasures did not apply under NAFTA Chapter 11, and that to stay proceedings and await resolution at the inter-state level would be impracticable.¹⁷³

If we are to apply the principle of CIL as codified in the ILC Articles, it is clear that there is no requirement of the existence of a tribunal decision on the alleged breach prior to the taking of countermeasures. Even in *Air Services Arbitration*, the tribunal found there is no need for such an initial finding after all. In fact, the United States took its retaliatory action even before the dispute was submitted to arbitration, and it was deemed legal as long as the action was meant to hasten the arbitration.¹⁷⁴ This is particularly critical because if there needs to be a finding by a court of an initial breach, it may be harder for arbitral tribunals to determine the legitimacy of countermeasures.

3. Criteria of Countermeasures

The tribunal in *ADM v. Mexico*, citing the case of *Gabchikovo-Nagymaros* and the ILC Articles, required four cumulative conditions for Mexico to successfully raise the defence of countermeasures, namely 1) the US breached NAFTA Chapter 3 and/or 7 and Chapter 20, 2) Mexico's measure was enacted in response to the alleged breaches, and was intended to induce US compliance with its NAFTA obligations concerning access to Mexican sugar to the US market and concerning obligations pursuant to NAFTA Chapter 20, 3) Mexico's measure was proportionate, and 4) Mexico's measure did not impair individual substantive rights of Claimants.¹⁷⁵

In contrast, the tribunal in *Corn Products v. Mexico* cited *US-France Air Services Case* besides *Gabchikovo-Nagymaros* to formulate six criteria of legitimate countermeasures including, 1) taken in response to a prior breach of international law, 2) directed against that wrongdoing state, 3) taken to induce the state to comply with its international obligations, 4) limited in time and taken in an a way as to permit resumption of the performance of the obligations, 5) proportionate to the injury caused by the original wrongful act, and 6) accompanied by a call on the state responsible to fulfill its obligations and a good faith attempt to negotiate or resolve the dispute through other forms of dispute settlement.¹⁷⁶ Overall this is a more accurate reflection of the criteria for legitimate countermeasures under the ILC Articles.¹⁷⁷

The tribunal in *Cargill v. Mexico* referred to the ILC Articles as 'an important point of departure' to address this matter,¹⁷⁸ but did not mention at all what would constitute legitimate countermeasures. The tribunal found it had jurisdiction to determine the legitimacy of Mexico's countermeasure,¹⁷⁹ but came to the conclusion that countermeasures could not preclude the wrongfulness of acts in respect of a claim under NAFTA Chapter 11 after going through the award of the *ADM v. Mexico* tribunal, disagreed to the award, and decided that individuals have their own rights.¹⁸⁰

Of all the tribunals, only the tribunal in *ADM v. Mexico* went through the criteria. We will not analyze all the criteria, but only proportionality and the fourth criteria of non-impairment of individual substantive rights of Claimant which are rather problematic.

The tribunal referred to Article 51 ILC Articles which requires countermeasures to be "commensurate with the injury suffered, taking into account the gravity of the internationally wrongful act and the rights

¹⁷³ *Ibid*, ¶190-191.

¹⁷⁴ *Air Services Arbitration*, *supra* note 29, ¶84-89, 95.

¹⁷⁵ *ADM v. Mexico*, *supra* note 2, ¶125-127.

¹⁷⁶ *Corn Products v. Mexico*, *supra* note 97, ¶145-146.

¹⁷⁷ Article 22 and 49-53 ILC Articles.

¹⁷⁸ *Cargill v. Mexico*, *supra* note 97, ¶420.

¹⁷⁹ *Ibid*, ¶430.

¹⁸⁰ *Ibid*, ¶429.

in question.” Besides relying on that provision to conduct a qualitative comparison between all related international obligations,¹⁸¹ the tribunal also assessed proportionality based on the appropriateness of the aim compared to the structure and content of the breached rule (aim-approach).¹⁸²

For the aim-approach, the tribunal cited the *Case Concerning the United States Diplomatic and Consular Staff in Tehran* to illustrate that the aim of the countermeasure has to be connected to the alleged breach. In that case, Iran claimed in letters by its Minister of Foreign Affairs that US’ breach of international obligations justified the seizure of the US diplomatic offices and personnel in Tehran.¹⁸³

It is surprising that the tribunal cited the *Tehran Case* while Iran did not specifically raise the defence as countermeasures of CIL nor furnished any further information regarding the alleged criminal activities of the US.¹⁸⁴ In fact, the ICJ did not make a finding about proportionality in rejecting the defence. Rather the ICJ only found that the defence was unacceptable “...because diplomatic law provides necessary means of defence against, and sanction for, illicit activities by members of diplomatic or consular missions...”¹⁸⁵ This is to show the *lex specialis* nature of diplomatic or consular issues as regulated under the VCCR as reflected in Article 50(2)(b) ILC Articles regulating about the inviolability of diplomatic or consular agents, premises, archives and documents. However, the tribunal still used the case and extracted its own test of proportionality from the case: “Iran had at its disposal other measures to put an end to the alleged wrongful acts by the United States and could have resorted to other means for obtaining cessation of those acts without impairing the function of diplomatic law.”¹⁸⁶

The failure to resort to a measure not impairing the function of diplomatic law was assumed as a different aim not connected to the alleged breach of the US. This approach can be problematic if applied in the context of NAFTA Chapter 20 countermeasures those are allowed upon a panel decision of non-compliance.¹⁸⁷ In certain situations, the establishment of a panel itself may not be possible because the initial violator refused to cooperate. As such, any countermeasures taken in such situation can be interpreted as impairing the function of NAFTA, thus non-proportionality may always be found. This could effectively rendered countermeasures under Chapter 20 futile. The tribunal in *ADM v. Mexico* could have avoided coming into analysis because the lack of correlation between the aim and the alleged breach had been proven earlier through the evidence that Mexico took the measure merely to protect its domestic industry.

According to the aim-approach, the availability of other measures to put an end to the breach without impairing the law in the more general context is critical to determine the proportionality of a countermeasure. This in some way reminds us of the less trade restrictive measure approach in the WTO in the assessment of the word “necessary” under Article XX of the GATT.¹⁸⁸ Even in the WTO, this approach will require the complaining Member to identify the possible alternatives to the measure that the other Member could have taken.¹⁸⁹ The aim-approach goes to a further extreme of requiring non-impairment. It remains questionable whether this approach can be adopted in the context of

¹⁸¹ *ADM v. Mexico*, *supra* note 2, ¶155.

¹⁸² *Ibid*, ¶154.

¹⁸³ *Case Concerning the United States Diplomatic and Consular Staff in Tehran (United States v. Tehran)*, International Court of Justice, Judgment of 24 May 1980, ¶81.

¹⁸⁴ *Ibid*, ¶82.

¹⁸⁵ *Ibid*, ¶83.

¹⁸⁶ *ADM v. Mexico*, *supra* note 2, ¶156.

¹⁸⁷ Article 2019 NAFTA.

¹⁸⁸ AB Report, *United States — Standards for Reformulated and Conventional Gasoline [US-Gasoline]*, (1996) WT/DS2/AB/R, ¶23-24; Panel Report, *US – Gasoline*, (1996) WT/DS2/R, ¶6.26, 6.28; AB Report, *European Communities — Measures Affecting Asbestos and Products Containing Asbestos*, (2001), WT/DS135/AB/R, ¶171.

¹⁸⁹ AB Report, *Brazil — Measures Affecting Imports of Retreaded Tyres*, (2007), WT/DS332/AB/R, ¶156.

countermeasures in trade and investment law due to the nature of countermeasures that constitute breach of international law whose wrongfulness is precluded. Requiring non-violation of the law in a more general context seems to be excessively demanding. Neither the claimants nor the tribunals actually provided the alternative countermeasures that could have been taken by Mexico in the case of *ADM v. Mexico*.

Although availability of a less-restrictive measure may be taken into account for proportionality test, the fact that another measure is available should not make certain countermeasures disproportionate. This should require further analysis of the measures. Furthermore, it is not certain that taking the other measure would meet the aim of ending the breach itself because the breaching state has the discretion to determine its own actions.

The tribunal continued to analyze the proportionality of the countermeasures based on qualitative-comparison approach. It assessed the alleged breaches of NAFTA Chapter 7 and Chapter 20 on trade-related obligations with regard to agricultural goods and to sanitary and phytosanitary measures, as well as obligations for state-state dispute settlement, and compared them with NAFTA Chapter 11 obligations which make private individuals (investors) as the direct object and beneficiaries, notwithstanding the fact that they do not hold individual substantive rights.¹⁹⁰

The tribunal found that since the obligations allegedly breached by the US were inter-state obligations, but the countermeasures breached obligations towards private individuals, then the countermeasure was not proportionate nor necessary nor reasonably connected to the aim of Mexico to induce the US' compliance.¹⁹¹ This line of reasoning demonstrates that the tribunal goes back to the aim approach and implies that Mexico should have resorted to other inter-state obligations under NAFTA when taking countermeasures. Even more explicitly, the tribunal said that "Mexico's aim to secure compliance by the US of its obligations under Chapter VII and XX could have been attained by other measure not impairing the investment protection standards under Section A [Chapter XI of NAFTA]."¹⁹² The tribunal did not specify what the measure could be, and simply concluded that Mexico's countermeasures did not meet the proportionality requirement for a legitimate countermeasure under CIL.¹⁹³ Meanwhile, in reality resorting to other inter-state obligations, especially in the trade area, could still breached obligations towards individuals, as illustrated above in the areas of services and IP rights.¹⁹⁴

This is startling because if followed to its logical conclusion, trade countermeasures, which in nature would always arise out of inter-state obligations, will never be legitimate countermeasures in international investment law. With the increasing integration of trade and investment by way of GVCs, trade countermeasures will in most cases have implication on investors. The rise of the GVCs across the world makes foreign investors present in most parts of the world, and they can be subject to trade measures of WTO Members, including countermeasures that may affect their investments, for example: suspension of concessions in Agreement on Trade in goods – e.g. taxes, suspension of concession in GATS – e.g. limitation of market access or deviation from national treatment to nationals of offending state in a specific sector, or suspension of protection of IP rights.

Simply, the qualitative approach should not have been the test used because all countermeasures taken under IIAs will likely violate this test of proportionality. Instead, the tribunal should analyze the

¹⁹⁰ *ADM v. Mexico*, *supra* note 2, ¶157.

¹⁹¹ *Ibid.*, ¶158.

¹⁹² *Ibid.*, ¶159.

¹⁹³ *Ibid.*, ¶160.

¹⁹⁴ See Part III.B.1 above.

gravity of the alleged breach and the gravity of the countermeasures. The proportionality of the measure should be weighed against the alleged breach, instead of whether investors are affected.

The fourth criteria brought the tribunal to assess the nature of rights under NAFTA Chapter 11 as elaborated above. This criterion of non-impairment of individual rights of the claimant was never included in the ILC Articles.¹⁹⁵ The tribunal ended up finding that individuals only enjoy the procedural right to invoke the responsibility of the host state.¹⁹⁶ Since the tax measures (countermeasures) did not affect that procedural right, it did not undermine the validity of the countermeasures.¹⁹⁷

V. Resolving the Tension on Countermeasures between Trade and Investment Law

This section seeks to propose several thoughts to resolve the tension between the two regimes.

A. *Individual Rights in International Investment Law*

1. Substantive v. Procedural or False Dichotomy?

Of all issues addressed by the investment tribunals above, the biggest issue is whether defence of countermeasures is available under NAFTA Chapter 11. Absent the defence, WTO Members may not be able to take legitimate trade countermeasures that impact investors. At least from the discussion of the two tribunals, *Corn Products v. Mexico* and *Cargill v. Mexico*, the most critical question is regarding the nature of rights of investors under NAFTA Chapter 11, or in a more general context, under IIAs—whether individuals have rights under IIAs.

The advent of the human rights movement and international investment law, requires us to rethink what the recognition of individual right means in the doctrine of diplomatic protection. We argue that this word should be unpacked in today's context. Individuals may have a right separate from states, arising from contracts with states (including concession contracts), inalienable human rights, and constitutional rights. This is clear in international law and domestic law. Conversely, in the case of investment rights found inside IIAs (BITs or investment chapters in FTAs), we suggest that these benefits are connected to the rights of the home states and not severable independent rights.

It does not really matter whether they have substantive right or procedural right as argued by the NAFTA tribunals, but what matters under Article 49 ILC Articles is that they must have independent individual right, *sans* attachment to the rights of states, such as inalienable human rights. On the other hand, if it is rights obtained through treaties, such rights remain revocable by the state parties. Absent the treaty, no such right exists. Simply, the rights are anchored in the investment treaties they stem from.¹⁹⁸ An example to this notion is two states (State A and B) are parties to the International Centre for the Settlement of Investment Disputes (ICSID) Convention. They also have a BIT between them providing that a dispute arising from the BIT between an investor of a Contracting Party and the other Contracting Party shall be submitted to the ICSID. At one point, State A decides not to use the ICSID mechanism anymore and refuses to entertain any case brought to the Centre by investors of State B. In response, State B takes a similar measure as a countermeasure and refuses to entertain any case brought against it by the investors of state B before the ICSID. In such a case, investors are left without any rights to enforce the state parties to the treaty to comply. This demonstrates that the rights remain solely of the states.

¹⁹⁵ Antoni and Ewing-Chow, 344.

¹⁹⁶ *ADM v. Mexico*, *supra* note 2, ¶179.

¹⁹⁷ *Ibid.*

¹⁹⁸ Francisco Gonzales de Cossio, "Investment Protection Rights: Substantive or Procedural", available at <http://208.56.169.136/PDF/Arbitraje/Investor%20Rights%20Procedural%20or%20Substantive.pdf>, 10.

In IIAs, it is the rights of both states to have their citizens protected when investing abroad and their obligations to provide such protection to the citizens of the other parties. The citizens are merely beneficiaries of the treaties. This is supported by the fact that the ILC Articles clearly foresees this possibility that companies may lose business or even go bankrupt because of certain countermeasures, but that does not affect the legitimacy of the countermeasures. It mentioned specifically,

“For example, if the injured State suspends transit rights with the responsible State in accordance with this chapter (countermeasures), other parties, including third States, may be affected thereby. If they have no individual rights in the matter they cannot complain. The same is true if, as a consequence of suspension of a trade agreement, trade with the responsible State is affected and one or more companies lose business or even go bankrupt. Such indirect or collateral effects cannot be entirely avoided.”¹⁹⁹ [emphasis added]

When it referred to third parties, it also mentioned third States that basically have their own independent rights. The previous ILC Commentary confirms this interpretation because it provides more example of private individuals, e.g. companies, who basically have no independent individual rights on their own and only derive those rights from treaties. For this reason, even if it is argued that IIAs render procedural rights, countermeasures do not violate this right.

2. Historical Development of Individual Rights in International Law

In the past, the right of individual in international law is recognized through the doctrine of diplomatic protection. Under the doctrine, an injury to an individual by a foreign state is actionable by the individual’s state of nationality. In its development, individual may have an access to bring a direct claim against a state at international forums through “mixed claims”, especially on matters pertaining human rights.²⁰⁰

It may be useful to track the development of individual in international law to understand this matter better. The application of diplomatic protection began in the late eighteenth century. In diplomatic protection, Vattel opined that the rights and obligations of the protection of citizens were state rights, not individual rights.²⁰¹

In the 19th and early 20th centuries, various arbitrations had taken place relating to disputes over claims relating to the imposition of excessive customs duties,²⁰² treatment of nationals (arrest or imprisonment),²⁰³ expropriation of property,²⁰⁴ and breach of contract by a state.²⁰⁵ Although the treaties referring these claims to arbitration did not specify the act as a violation of a state right or an individual

¹⁹⁹ ILC Articles Commentary, *supra* note 1, 130, ¶5.

²⁰⁰ Kate Parlett, *The Individual in the International Legal System* (New York: Cambridge University Press, 2011), 47.

²⁰¹ E. de Vattel, *The Law of Nations or, Principles of the Law of Nature Applied to the Conduct and Affairs of Nations and Sovereigns* (1758, B. Kapossy and R. Whatmore (eds.), Indianapolis, Liberty Fund, 2008), bk II, ch. VI, 298, ¶71.

²⁰² Great Britain – France, 14 November 1842, A. de Clerq (ed.), *Recueil des Traités de la International Arbitrations*, vol. V, p. 4936; Great Britain – Portugal, 14 November 1842, vol. V, p.4979 (Award).

²⁰³ Great Britain – Peru, 1864, J.B. Moore, *History and Digest of the International Arbitrations to which the United States has been a Party* (Washington, DC, Government Printing Office, 1898), vol. V, p. 4967; Spain – US, 16 June 1870, vol. II, p. 1007; Great Britain – Colombia, 14 December 1872, vol. II, p. 2050.

²⁰⁴ Great Britain – Russia, 1 June 1902, IX UNRIAA 51.

²⁰⁵ US – Paraguay, 4 February 1859, Moore, *International Arbitrations*, vol. II, p. 1485; Great Britain – US, 1 July 1863, vol. I, p. 237.

right, the procedures used in these arbitrations suggested that the claims were inter-state claims.²⁰⁶ The state of nationality had control over the claims throughout the whole procedure,²⁰⁷ entitled to receiving payment of the awards,²⁰⁸ and received legally binding decisions on an inter-state basis.²⁰⁹ The exception at that time was the Central American Court of Justice which gave individuals exclusive control of claims.²¹⁰ Even so the Court did not treat the individuals as having any direct rights from international law, but merely a procedural right.²¹¹ This still follows closely Vattel's approach.

The Permanent Court of International Justice (PCIJ) affirmed the doctrine of diplomatic protection in the *Mavrommatis* case as a right of a state to ensure respect for the rules of international law.²¹² Furthermore, in *Chorzów Factory*, the PCIJ indirectly affirmed that in a diplomatic protection claim, the rights at issue are states' rights, not individual rights.²¹³

After World War I, post-war tribunals and commissions were established to deal specifically with claims for injury to individuals. The Peace Treaties (Treaty of Versailles) conferred direct international rights on individuals.²¹⁴ Similarly, the *Upper Silesian Mixed Commission and Arbitral Tribunal* also operated in such a way where Germany and Poland signed a convention that allowed individuals to assert a private dispute against a state (including their own state of nationality) which related to the protection of their rights by the Geneva Convention Concerning Upper Silesia (Geneva Convention), and which gave access to individuals to a mixed commission in cases where disputes relating to minorities protection.²¹⁵ The tribunal operated on the basis that individuals had rights under international law.²¹⁶ The formulation of the treaty clearly indicates this, as shown in Article 67 (1) of the Geneva Convention:

“All German nationals shall be equal before the law and shall enjoy the same civil and political rights without distinction as to race, language or religion.

All Polish national shall be equal before the law and shall enjoy the same civil and political rights without distinction as to race, language or religion.”

This era witnessed the starting point of recognition of individual rights under international treaties where the state parties so intended. The practice reflected the idea that states may confer upon individuals “international rights *strict sensu*, i.e. rights which they acquire without the intervention of municipal legislation and which they can enforce in their own name before international tribunals.”²¹⁷ This is shown from Article 147 of the Geneva Convention:

²⁰⁶ Parlett, *supra* note 200, 53.

²⁰⁷ US – Great Britain, 19 November 1794, Moore, *International Arbitrations*, vol. I, pp. 271, 277, and 322.

²⁰⁸ US – Great Britain, 8 February 1853, Moore, *International Arbitrations*, vol. I, pp. 391, 406.

²⁰⁹ Parlett, *supra* note 200, 58-59.

²¹⁰ El Salvador – Nicaragua – Costa Rica – Honduras – Guatemala, Art. 2, 20 December 1907 (1908) 2 AJIL 231.

²¹¹ Parlett, *supra* note 200, 65.

²¹² *Mavrommatis Palestine Concessions*, Judgment No. 2, PCIJ Rep. ser. A no. 2 (1924) 12.

²¹³ *Chorzów Factory*, *supra* note 81, 26-28.

²¹⁴ Treaty of Versailles, 28 June 1919. The treaty granted jurisdiction to mixed arbitral tribunals over claims relating to contracts, debts, damage to property, rights and interests by the application of certain war measures, compensation, as well as licenses for certain property rights. See for example: *Sigwald Charles v. Germany*, French-German Mixed Arbitral Tribunal, 27 August 1926, 4 ILR 337; *Lederer v. German Government*, Anglo-German Mixed Arbitral Tribunal, (1924) *Recueil des Décisions de Tribunaux Arbitraux Mixtes* 762, 768.

²¹⁵ Germany-Poland, Geneva Convention Concerning Upper Silesia, 15 May 1922, 9 LNTS 466.

²¹⁶ Parlett, *supra* note 200, 76.

²¹⁷ R. Jennings and A. Watts, *Oppenheim's International Law*, 9th ed. (London: Longmans, 1992), 847, ¶375.

“The Council of the League of Nations shall be competent to decide upon any individual or collective petitions relating to the provisions of this Part or addressed directly to it by persons belonging to a minority...” [emphasis added]

After 1945, in *Interhandel*, the ICJ affirmed the doctrine of diplomatic protection as expounded by the PCIJ in *Mavrommatis*. In this case, the Swiss government brought a claim on behalf of Interhandel, a Swiss company, that the US was under the obligation to restore Interhandel’s assets in the US based on Article IV paragraph (1) of the Washington Accord 1946 that provides, “The Government of the United States will unblock Swiss assets in the United States. The necessary procedure will be determined without delay.”

The language of Article IV (1) Washington Accord 1946 does not grant substantive right to an individual — instead it only imposes obligations on the states. When the ICJ mentioned that the state had “adopted the cause of its national” whose rights had been violated,²¹⁸ it may indicate that the property right of individual did exist under national law. However that right does not exist in international law. It was through this provision that Swiss government obtained the right to exercise diplomatic protection specifically with regard to the assets. The provision did not grant an individual right to the investor. The same actually applies with most IIAs, but in these agreements, states take an extraordinary approach of allowing individuals to bring claims. However, the rights remain of the states, except provided differently.

This narrows the discussion to when a treaty may confer rights to individual. In *Avena v. Mexico*, the ICJ affirmed that individuals may acquire rights directly under international treaties.²¹⁹ In this case, it analyzed Article 36(1) of the Vienna Convention on Consular Relations 1963 (VCCR) which provides:

“With a view to facilitating the exercise of consular functions relating to nationals of the sending State:

- (a) consular officers shall be free to communicate with nationals of the sending State and to have access to them...”

Based on the plain reading of the provisions, the ICJ concluded that it confers rights to individuals. It did not even inquire about the intention of the contracting parties to the convention.²²⁰ This approach can be contrasted with the approach of the PCIJ in *Danzig* where the latter required states parties to a treaty to demonstrate clear intention when they sought to confer rights on individuals.²²¹ This demonstrates that possibly in determining the existence of individual rights before international law, one has to look at the language of the specific treaty.

3. Textual Interpretation of the IIAs

The Vienna Convention on the Law of Treaties 1969 (VCLT), Article 31 (1) requires for an interpretation to be done “in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context in the light of its objects and purpose”. In this regard, if we look at the formulation of Section A of NAFTA Chapter 11, for example Article 1102, the text provides:

“Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment,

²¹⁸ *Interhandel (Switzerland v. United States)*, Preliminary Objections [1959] ICJ Rep. 6, 27.

²¹⁹ *LaGrand (Germany v. United States)* [2001] ICJ Rep. 466 [LaGrand], 492-4, ¶77; *Avena and other Mexican Nationals (Mexico v. United States)* [2004] ICJ Rep. 12.

²²⁰ *LaGrand*, ¶77.

²²¹ *Jurisdiction of the Courts of Danzig (Pecuniary Claims of Danzig Railways Officials who have Passed into the Polish Service, Against the Polish Railways Administration)*, PCIJ Rep. ser. B no. 15 (1928) 17-18.

acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.”

Applying the rules of interpretation under the VCLT, the language of this provision does not confer direct rights to investors. Let us look at the formulation in some other treaties:

“More particularly, each Contracting Party shall accord to such investments treatment which in any case shall not be less favourable than that accorded either to investments of its own nationals or to investments of nationals of any third State, whichever is more favorable to the national concerned.”²²²

“Each Party shall accord to investors of the other Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory.”²²³

Similarly, the plain reading of the provisions above indicates that the agreements do not grant direct individual rights to investors, but impose obligations on states. This may be different than other treaties using a hybrid-approach, such as:

1. Indonesia – UK BIT²²⁴

“Neither Contracting Party shall in its territory subject investments or returns of nationals or companies of the other Contracting Party to treatment less favourable than that which it accords to investments or returns of nationals or companies of any third State.”²²⁵

“Investments of nationals or companies of either Contracting Part shall not be nationalised, expropriated or subjected to measures having effect equivalent to nationalization or expropriation ...”²²⁶

2. Germany Model BIT²²⁷

“Neither Contracting State shall in its territory subject investments owned or controlled by investors of the other Contracting State to treatment less favorable than it accords to investments of its own investors or to investments of investors of any third State.”²²⁸

“Investments by investors of either Contracting State shall enjoy full protection and security in the territory of the other Contracting State.”²²⁹

If we are to strictly apply for the rules of interpretation of the VCLT to determine whether an individual right exists, then investment treaties with NAFTA-type language do not provide independent rights to

²²² Article 3 (2) Netherlands Model BIT (1997).

²²³ Article 3 (1) United States Model Bilateral Investment Treaty (2012).

²²⁴ Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Indonesia for the Promotion and Protection of Investments (1976) [Indonesia – UK Model BIT].

²²⁵ *Ibid*, Article 4 (1).

²²⁶ *Ibid*, Article 5 (1).

²²⁷ Germany Model BIT (2005).

²²⁸ *Ibid*, Article 3(1).

²²⁹ *Ibid*, Article 4(1).

investors, but some provisions of treaties using the hybrid approach may confer the rights. However, we argue that this interpretation is not useful because only relying on the text without the context may lead to diverse interpretations.

4. Interpretation of the Treaty and General International Law

According to Article 31 VCLT, interpretation must also take into account the overall context of the agreement along with its object and purpose. In the case of FTAs such as NAFTA, a tribunal interpreting the Investment Chapter of a FTA should take into account other Chapters, including Chapter 20. By virtue of such interpretation, as explained earlier above, countermeasures can be taken under Chapter 20. If it is available under Chapter 20, the conclusion will be that it will also be available under CIL, and this in effect confirms our understanding that even if individuals may have right under IIAs, it remains a non-independent right.

With regard to the availability of the defence of countermeasures arising from CIL in other IIAs, this should be perceived as such because the rules of state responsibility continue to apply with regard to state actions under the relevant agreement,²³⁰ except if it is explicitly excluded by the parties of the agreement.

5. Implementing the Intermediate Theory

Although we are persuaded by the intermediate theory adopted by the tribunal in *ADM v. Mexico*, we disagree with the classification of procedural and substantive rights done by the tribunals in *ADM v. Mexico* and *Corn Products v. Mexico*. Rovine in his concurrence of *ADM v. Mexico* tribunal mentioned specifically that the ILC Articles “do not distinguish between procedural rights that may be superseded by countermeasure, and substantive rights that may not.”²³¹ Even so he argued that the legal redress for the wrong committed under Section A of Chapter 11 constituted a substantive right.²³² The tribunal in *Cargill v. Mexico* also preferred not to characterize whether the rights under Chapter 11 are procedural or substantive, but emphasized on the ability of the investor to institute a claim.²³³

We differ from Rovine and the tribunal in *Cargill v. Mexico* and argue that investors do not have individual rights because basically the rights to investment protection are derived from the home state’s right and fully dependent on the state parties.²³⁴ This is confirmed by the tribunal in *Loewen* which stated that under NAFTA Chapter 11, “claimants are permitted for convenience to enforce what are in origin the rights of Party States.”²³⁵ The tribunal in *Cargill v. Mexico* should not have merely focused on the origin of the right in dismissing the derivative nature of investors’ rights, but it should focus on the continuation of the right. In fact, this is supported to the well-known principle of *jus tertii* in contract law that parties to a contract may agree to make a third party as the beneficiary of the contract and accordingly give the third party the right to sue the promisor. In such case, simply the rights ceases when the parties decide to terminate it.

Furthermore, this is different from rights arising from concessions contracts entered into between a state and a private investor. In such a contract, both parties have their own respective rights and obligations. Private investors have rights in the contract and can enforce the contract before tribunals,

²³⁰ *Gabčíkovo-Nagymaros*, *supra* note 3, ¶47.

²³¹ *ADM v. Mexico*, Concurring Opinion of Arthur W. Rovine, Issues of Independent Investor Rights, Diplomatic Protection and Countermeasures (21 Nov 2007), ¶4.

²³² *Ibid.*, ¶46-48.

²³³ *Cargill v. Mexico*, *supra* note 97, ¶426.

²³⁴ Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (The Netherlands: Kluwer Law International, 2009), 511, §10.19.

²³⁵ *Loewen v. US*, *supra* note 121, ¶233.

including arbitration if the terms of the contract provides as such. In contradistinction, in the last 50 years in order to create better investment climate, states have decided to render benefits to investors, regardless the fact that they are not direct parties to the treaties by way of BITs and Investment Chapters in FTAs. The investors simply obtain the benefit of these agreements from the creation of network of rights and obligations by their home states and relevant host states. Only in the former case of direct contract with states like concessions contract, do investors enjoy independent rights and simply countermeasures cannot preclude wrongfulness arising thereof.

By finding that investor has no independent right under IIAs, the tension of legitimate trade countermeasures in investment law may be resolved. The Commentary to Article 22 ILC Articles provides that indirect or consequential effects on countermeasures on third parties which do not involve an independent breach of any obligation to those third parties will preclude wrongfulness.²³⁶ The Commentary to Article 49 ILC Articles went further to recognize that legitimate reprisals against an offending state may even affect nationals of an innocent state as an indirect and unintentional consequence which the injured state will always endeavor to avoid or limit as far as possible, but at the same time indirect or collateral effects to one or more companies cannot be entirely avoided.²³⁷ It also mentioned that, “if they have no individual rights, they cannot complain”.²³⁸ By adopting the intermediate theory, individual rights of investors are not independent from the rights of state under IIAs, and thereby they cannot complain. Accordingly, legitimate trade countermeasures shall remain lawful in investment law.

B. Issuance of Joint-Interpretation of the Treaty by the State Parties

If decoding the nature of individual right in International Investment Law fails to solve the tension between trade and investment regimes, and it is still believed that investment treaties confers individual rights —both substantive and procedural, then we need an alternative solution. Simply, it is incomprehensible that a legitimate trade countermeasure, especially one that has been authorized by the WTO, can be considered illegitimate or even inadmissible before an arbitral tribunal either established under NAFTA or other IIAs. Allowing such a paradox to continue simply restrict states’ options of countermeasures, and even discredit the notion of countermeasures that has been an effective mechanism to ensure compliance in the DSM.

In the case of NAFTA, this tension can probably solved by having the NAFTA Free Trade Commission (FTC)²³⁹ to issue a binding interpretation of NAFTA Chapter 11 under Article 1131 NAFTA. In the interpretation, the FTC can clearly state that:

“The provisions under Section A of Chapter 11 of the NAFTA do not confer substantive rights to investors. The protection that investors enjoy is derived from their home states’ rights in the Agreement. Section B of Chapter 11 of the NAFTA confers procedural rights to investors to directly enforce the derived rights in Section A.”

Accordingly, with no rights of their own under the Chapter, any unintended breach to the Chapter caused by countermeasures will be precluded from its wrongfulness.

Alternatively, the FTC can issue a statement that clarify the relationship between NAFTA Chapter 11 and Chapter 20, specifically Article 1115 and Article 2019. For example, it can clarify by stating that

²³⁶ ILC Articles Commentary, *supra* note 1, 75.

²³⁷ *Cysne*, *supra* note 3, 1056-1057.

²³⁸ ILC Articles Commentary, *supra* note 1, 130.

²³⁹ *See* Article 2001 NAFTA.

“Nothing in Chapter 11 of the NAFTA may prohibit a Party to take measures in accordance with Article 2019 of the NAFTA.”

Despite this proposed solution, the test of proportionality as developed by the tribunal in *ADM v. Mexico* also needs to be addressed. In contrast to the WTO which required an authorization of the DSB prior to the taking of a countermeasure, NAFTA does not have that procedure. However, they both allow for the other Member State to request a panel to assess the legitimacy of countermeasures. Upon a Chapter 20 panel’s approval of the legitimacy of the countermeasure, we believe that Chapter 11 arbitral tribunal should pay due deference to the decision of the initial panel. For this purpose, it will be useful to include another clarification clause, “Measures that have been approved by a panel under Article 2019 of the NAFTA is not subject to any evaluation by arbitral tribunal established under NAFTA Chapter 11.”

Newer IIAs, such as the ASEAN Comprehensive Investment Agreement (ACIA) also allows a request for a joint interpretation of any provision of the agreement from the Member States. Article 40 (2) ACIA provides that the tribunal on its account or at the request of a disputing party shall request a joint interpretation of any provision of the agreement that is in issue in a dispute.²⁴⁰ Then, the Member States shall submit in writing their joint decision regarding the interpretation to the tribunal. Such a joint decision shall be binding on a tribunal, and the decision or award issued by the tribunal shall be consistent with the joint decision. This is explicitly provided in the ACIA.

Unfortunately, BITs do not have a mechanism for the parties to the agreements to provide their joint-interpretation of provisions in the agreements. This should not prohibit treaty parties to those BITs from issuing a joint-interpretation. Despite the absence of explicit provisions for such a mechanism, Article 31 (3)(a) VCLT clearly requires subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provision to be taken into account. As such, when they apply this customary rules of interpretation on the BIT, tribunals shall take into account such joint-interpretation as highly persuasive evidence in deciding a dispute involving such a situation.²⁴¹

The mechanism of joint-interpretation still pleads for a question to be answered: which provision should be interpreted to clarify the relationship between trade countermeasures and investment countermeasures? Since no BIT contains a provision on countermeasures, we suggest for a joint-interpretation on instituting a claim before investor-state arbitration. The joint-interpretation may to include a clause such as, “An investor may bring a claim against the breach of this agreement subject to legitimate trade countermeasures.”

This may seem to be an oversimplification of joint-interpretation, and we do recognize that if the joint-interpretation in effect actually amends the treaty, it will have to go through certain procedure as required by the BIT itself. However, we argue that it does not amend the BIT because as recognized by the tribunals, the notion of countermeasures under CIL does exist for treaty parties of IIAs based on the formulation of most arbitration rules that international law shall continue to apply.²⁴² Additionally, it is also available as part of the rules on state responsibility that should apply on the conducts of states, including with regards to the treaty itself.

We also note that an issue may arise as regards the willingness of the treaty parties to issue this type of joint-interpretation, especially given that the area of countermeasures remains less clear. However, the

²⁴⁰ See also Article 15.21 Singapore – United States FTA (2003).

²⁴¹ For further reading regarding this matter: Anthea Roberts, “Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States”, (2010) 104 AJIL 179.

²⁴² This is especially true in the case of ICSID Arbitration where the parties to the BIT do not agree on the applicable law, see Article 42(1) ICSID Convention).

fact that the question arising from the existing disputes actually raises an important concern for the trade interests of these states, we believe that there is some merit to believe that joint-interpretation will be possible.

C. Write into BITs and IIAs a clause that says if WTO-authorized it is not a breach

An alternative to the creation of a body is to amend IIAs by including a clause that recognizes the right of parties to take countermeasures, specifically in relations to legitimate trade countermeasures, such as that authorized by the WTO. This is especially useful for the parties who are members of the WTO or members of certain FTAs. The clause can be formulated as follows:

“Nothing in this agreement shall prevent a Contracting Party from taking a trade countermeasure that has been authorized by the Dispute Settlement Body of the World Trade Organization against the other Contracting Party, despite the fact that the countermeasure may have effects on investments of nationals or companies of the other Contracting Party under this agreement.”

The authors acknowledge that amending an IIA is not simple. Where an investment agreement does not specify the procedure to amend, Article 39 VCLT will be applicable, namely that any amendment can be done by agreement between the parties. As such, amending an agreement will require consent from both states. However, this may not be necessarily difficult to achieve especially when both members of the treaty are members of the WTO, there is a greater interest that in the future their countermeasures will also be recognized in investment regime. It is important to note that the amendment may need to happen long before any countermeasure is to be imposed. Otherwise, the party subject to the countermeasure may be reluctant to agree to such an amendment, especially when its affected investor has lobbied the government regarding the negative impacts that he/she may suffer. The other difficulty is the requirement to obtain ratification which will involve the legislative branch of the parties. Where political interest is at play, this is not an easy task.

Alternatively, where the parties cannot agree to amend, state parties may simply terminate the existing treaty and redraft a new treaty. However, this will have to wait until the termination time of the relevant treaty as regulated thereof. Even in this situation, consent by both members is needed in the process, and ratification process may pose an extreme political challenge to both parties.

VI. Conclusion

The paper has highlighted the prominent tension arising between the two regimes of trade and investment law. It is hard to discern that a legitimate trade countermeasure—that has gone through assessment of a dispute settlement body and authorized— can lead to an investment claim against the state. This issue is in fact becoming very imminent especially with the number of BITs concluded amongst states during the last 50 years and the increasing number of IIAs and FTAs with Investment Chapters those have been concluded and are being negotiated, coupled with the intrinsically close relationship between the two regimes. Not to mention the rising number of GVCs where investors have their operations in various different parts of the world. All these factors demonstrate the high likelihood of a similar case to the Sugar War arising in the future.

We note that in the Sugar War, Mexico may not have had good grounds to argue for legitimate trade countermeasures, but in other cases involving legitimate WTO-authorized countermeasures that affect foreign investors, resolution between the two regimes must be found.

We note that the central issue in the case is with regard the right of individual under IIAs. This is critical to determine whether countermeasures can preclude wrongfulness under the IIAs. If they do have individual rights, countermeasures may not preclude wrongfulness when the measures breach the IIAs.

In dealing with this subject matter, traditional methods of interpretation based on the text of the agreement may not be helpful to guide us because one can always come to multiple interpretations, especially with the vaguely drafted BITs. In interpreting the agreement, we should look at the context of the agreement, including its general framework (in the case of FTAs) and general international law that is applicable to the agreements at the same time, including how it relates to other agreements in order to come to a purposeful results of interpretation.

Even though textual reading of some IIAs may imply that they confer rights to investors, in reality the rights are not independent from the home states. This is clearly shown from the fact that the state parties may revoke the treaty, thereby no rights of investors are left and they cannot even complain regarding such revocation. In IIAs, the state parties remain the holders of the rights and obligations in the treaties, but individuals enjoy benefits thereof. In contrast, individuals do enjoy independent rights from concession contracts that they enter into with states, including the right to bring a claim if there is a breach of the contract. There is clearly a fundamental difference between the two instruments. Through this interpretation, we can find that investors do not enjoy independent individual rights and therefore legitimate trade countermeasures may preclude wrongfulness arising from breach of obligation in the relevant state's IIAs.

Further, we also note that in the case of a legitimate trade countermeasures, due deference should be given by arbitral tribunals because the countermeasures have gone through scrutiny of relevant bodies with the specific jurisdiction, i.e. the WTO DSB or the panel in NAFTA Chapter 20.

Additionally, it is critical to correct the misconception of the criterion of proportionality as suggested by the tribunal in *ADM v. Mexico* which will always lead to the finding of non-proportionality. The comparison of the nature of obligations between the defence and the breach in investment dispute is simply flawed.

We recommended several ways to resolve the tension, including 1) renewal of understanding regarding the nature of rights under investment agreements, including through intermediate theory; 2) issuance of joint-interpretation by state parties, and 3) amendment of investment agreements. The first suggestion may depend on relevant tribunals adjudging a case with such tension. There is no guarantee that the relevant tribunals will adopt such theory and interpretation method. Meanwhile the second and third suggestions will require further actions by state parties of IIAs, each requiring different political actions and may have their own difficulties. However, once taken, these two ways can ensure that such tensions will arise exist in the future and that legitimate trade countermeasures will be respected in International Investment Law.