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# INTERPRETATION OF IIAs: WHAT STATES CAN DO[1]

## I. Introduction

Recent years have seen growing concerns with investor-State dispute settlement (ISDS). As investors continue using ISDS to challenge host countries, their claims increasingly also touch upon regulations in the public interest, such as policies to promote labour or human rights, protect public health or preserve the environment. Recent challenges against tobacco marketing and packaging restrictions in Uruguay and Australia, adopted, in part, to implement the World Health Organization Framework Convention on Tobacco Control (FCTC) are worrisome examples. Confidence in the ISDS process is further compromised by concerns related to the quality and predictability of the awards issued by tribunals: some arbitral decisions have resulted in inconsistent findings or have lacked sound reasoning, sometimes as a result of poor treaty interpretation. Taken together, these developments risk undermining the legal security, coherence and predictability of the IIA regime (see *infra* section II.2).

## Highlights

- International investment agreements (IIAs) are concluded by States. Where IIAs refer to investor-State dispute settlement (ISDS), arbitral tribunals interpret IIA provisions in the context of an ISDS case.
- Some of these interpretations have raised concerns, because of a perceived lack of consistency, predictability and quality.
- As masters of their IIAs, States can be more proactive in asserting their interpretive authority to guide tribunals towards a proper and predictable reading of IIA provisions.
- States have various tools at their disposal (e.g. unilateral, bilateral and multilateral ones).
- Interpretive considerations may come into play at all the stages in the lifetime of an IIA, including the drafting, conclusion, application, dispute settlement and post-dispute stage.
- These interpretive tools constitute a complementary means for States – alongside treaty re-negotiations and amendments – for addressing some of the challenges the IIA regime faces today.

**Advance unedited version**

[1] This Note is based on background research UNCTAD commissioned to Andrea Saldarriaga to analyse the interpretation of treaties in the context of ISDS. The results of her extensive research on the issue will be published shortly as an independent article in an international law journal. The drafting of this IIA Issues Note was undertaken by Wolfgang Alschner, with guidance and inputs by Anna Joubin-Bret, Sergey Ripinsky and Elisabeth Tuerk and support from Peter Sauer. This Note also benefited from comments by Facundo Perez Aznar, Barry Appleton, Nathalie Bernasconi, Robert Howse, Katja Gehne, Christina Knahr, Markus Krajewski, Ursula Kriebaum, Andrew Mitchell, Joost Pauwelyn, Anthea Roberts, Andrea Saldarriaga, and Tania Voon.

In the recent past, States have started reacting to the challenges emerging from the current ISDS system. Some countries have terminated their investment treaties and withdrawn from ISDS, or certain aspects of it – an option that raises a number of complex and novel legal questions.[2] Others have worked to improve the treaty language that is at the origin of controversial claims[3] or challenged ISDS awards once they have been issued.[4]

As a further alternative, States can take a more proactive attitude when it comes to the interpretation of IIA obligations. In particular, they can foster a more predictable and coherent reading of treaty terms. This IIA Issues Note aims to highlight the potential role of interpretive approaches to address some of the challenges today's ISDS system poses for investment stakeholders around the globe. The Note makes a number of innovative suggestions, some of which remain untested in their practical application. It does not, however, suggest that interpretation would be a tool for amending or changing the content of a treaty, nor does it aim at criticizing the legal reasoning developed by ISDS tribunals or seek to make direct suggestions to arbitrators. Moreover, it should be noted that no single solution will prove sufficient to remedy all the system's inadequacies. Nor will each option suit every stakeholder. Nevertheless, the note aims to provide "value added" by shedding some light on the relatively unexplored topic of interpretation that is highly relevant for addressing current challenges facing the IIA regime, with a view to fostering debate and informed decision-making by investment policy makers and affected stakeholders.

This note is divided into three parts. Part one describes the shared authority of States and tribunals in the interpretive process, and sketches some of the current deficiencies in investment arbitration. It advocates a greater involvement of States in the interpretive process, but also considers limitations to a more proactive role of the contracting parties. Part two presents international law principles of interpretation and explains how they can guide States in their actions towards fostering a "better" (i.e. more rigorous, consistent and coherent) interpretation of IIAs. Finally, part three sets out different tools States may employ to guide arbitral tribunals in the interpretation of IIAs.

# II. Interpreting IIAs: Actors, Challenges and Limitations

The legal conclusion reached when applying the abstract rules of an IIA to the facts of a particular case often hinges on the critical intermediate step of interpreting the terms of the IIA. Interpretation delineates the scope of rights and obligations in IIAs and thereby helps distinguish between those acts that constitute an interference with investors' rights as set out in an IIA and those that fall within a State's legitimate right to regulate as recognized in international law. Carefully delineating this borderline is particularly important in investment law, where disputes proliferate in sensitive public policy areas and where broad and often vague protective treaty standards are common.

IIAs are inter-State treaties governed by public international law. Hence, investor-State dispute settlement proceedings, in contrast to commercial arbitrations, take place against a public international law background. It follows that unless an IIA specifies otherwise, arbitral tribunals have an obligation to interpret IIAs – like any other international treaty – following the general international law rules of treaty interpretation. These rules are primarily embodied in the Vienna Convention on the Law of Treaties (VCLT).[5] A rigorous application of interpretation rules by tribunals contributes to legal

[2] UNCTAD IIA Issues Note, Denunciation of the ICSID Convention and BITs, December 2010, http://www.unctad.org/en/docs/webdiaeia20106_en.pdf.

[3] UNCTAD *Series on Issues in International Investment Agreements (A Sequel)* on Most-Favoured Nations Treatment (Fair and Equitable Treatment and Expropriation forthcoming) available at http://www.unctad.org/iia.

[4] UNCTAD IIA Issues Note, Latest Developments in Investor-State Dispute Settlement, March 2011, http://www.unctad.org/en/docs//webdiaeia20113_en.pdf. It has to be noted that judicial review of arbitral awards by annulment committees (under the ICSID Convention) or national courts (outside the ICSID system) is primarily intended to safeguard the procedural rights of the disputing parties and not to review the substantive outcome of the award.

[5] Gardiner, Richard K.,*Treaty Interpretation* (New York: Oxford University Press), 2008, pp. 20ff.

predictability and protects the expectations of States on how treaty standards will be interpreted.[6]

## 1) Shared interpretive authority between States and tribunals

In the interpretation of IIAs, both arbitral tribunals and contracting States have a role to play. By introducing an ISDS mechanism into a treaty, States delegate the task of resolving investor-State disputes to international tribunals. This delegation confers arbitrators with a certain discretion to give meaning to treaty standards. The interpretive authority of arbitral tribunals, however, is not absolute. First, it is conditioned by principles of treaty interpretation. Second, it is shared with that of State parties to the treaty.

In international law States are the drafters and masters of their treaties. Even though States have delegated the task of ruling on investor claims to arbitral tribunals, they retain a certain degree of interpretive authority over their treaties: by virtue of general public international law, they can clarify their authentic intentions and issue authoritative statements on the proper reading of their treaties. As the Permanent Court of International Justice (PCIJ) noted "the right of giving an authoritative interpretation of a legal rule belongs solely to the person or body who has power to modify or suppress it."[7] This was later reaffirmed by the International Law Commission (ILC)[8], the International Court of Justice (ICJ)[9] as well as arbitral tribunals themselves.[10] Put differently, while it remains the task of the arbitral tribunal to decide a case and interpret and apply an IIA to this end, the contracting States retain the power to clarify the language/meaning of a treaty through an authoritative interpretation.

Therefore, although tribunals and contracting States play different roles in the interpretation of IIAs, they share interpretive authority. Interpreting IIAs is hence not a monologue by tribunals, but could be understood as a "constructive dialogue between investment tribunals and treaty parties".[11] However, until present, States have largely neglected their role in interpreting IIAs. Instead, they left the task of giving meaning to treaty provisions solely to arbitral tribunals. Yet, rising concerns among States and other stakeholders demonstrate the challenges of an overly wide discretion of arbitrators coupled with the often broad and imprecise language of IIAs.

## 2) Lack of predictability in current IIA interpretation by tribunals

There are a number of issues that raise concerns about the legal predictability of IIAs in ISDS proceedings. One relates to divergent interpretations of identically or similarly worded treaty obligations. For example, in response to its economic crisis in 2001, Argentina enacted a number of measures that were later challenged in investment proceedings, in the course of which tribunals and subsequent ICSID *ad hoc* Committees disagreed on the proper reading of the scope and content of Argentina's necessity defense pursuant to Article XI of the Argentina-*United States* Bilateral Investment Treaty (BIT) and its relationship to customary rules on State responsibility.[12]

Furthermore arbitral tribunals have not always rigorously followed general international rules of treaty interpretation and produced poorly reasoned awards. In 2008, Fauchald found that "*only in exceptional decisions did tribunals integrate the VCLT into their*

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[6] See for more detail Arsanjani, Mahnoush H./ Reisman, W. Michael, «Interpreting Treaties for the Benefit of Third Parties: The "*Salvors*' Doctrine" and the Use of Legislative History in Investment Treaties» Editorial Comment, *American Journal of International Law*, Vol. 104, No. 1, 2010, p. 598.

[7] Permanent Court of International Justice, *Jaworzina,* Advisory Opinion, 1923, P.C.I.J., Series B, No. 8, p. 37.

[8] Yearbook of the International Law Commission, 1966, Vol. II, p. 221, para. 14.

[9] International Court of Justice in the *Kasikili/Sedudu Island (Botswana/Namibia*), Judgement (13 December 1999), para. 63.

[10] See for example *ADF Group Inc. v. United States*, ICSID No. ARB(AF)/00/1 (9 January 2003), para. 177.

[11] Roberts, Anthea, «Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States», *American Journal of International Law*, Vol. 104, No. 1, 2010, p. 225.

[12] For instance *CMS v. Argentina*, Award, ICSID Case No. ARB/01/8 (12 May 2005); *Enron v. Argentina*, ICSID, Award, Case No. ARB/01/3 (22 May 2007); *LG&E v Argentina*, Decision on Liability, ICSID Case No. ARB/02/1 (3 October 2006); *Sempra v. Argentina*, Annulment Decision, ICSID Case No. ARB/02/16 (29 June 2010); *Enron v. Argentina*, Annulment Decision, ICSID Case No. ARB/01/3 (30 July 2010).

*reasoning beyond general references*."[13] In 2010 Arsanjani and Reisman criticized the improper use of the *travaux préperatoires* by tribunals.[14] The use and application of interpretation rules, however, is an essential element of an arbitral tribunal's mission to produce a well reasoned decision.

Finally, some arbitral awards fail to interpret IIAs in a manner giving due consideration to the balance of rights and obligations. The tribunal in *SGS v. Philippines*, for instance, found that it is "*legitimate to resolve uncertainties in [the IIA's] interpretation so as to favor the protection of covered investments*".[15] Failing to pay due regard to legitimate considerations other than investment protection, however, curtails the State's regulatory autonomy to the detriment of sustainable development. Along these lines, the tribunal in *Noble Ventures v. Romania* stated, *"it is not permissible, as is too often done regarding BITs, to interpret clauses exclusively in favor of investors*".[16]

In sum, deficiencies in the interpretive process with potentially negative consequences for public policy making merit attention by States. While ideally tribunals should employ international rules of treaty interpretation rigorously producing solidly reasoned awards, and make ISDS more consistent, predictable and legitimate, States can play an important role in fostering such outcome.

## 3) Greater involvement of States in interpretation and potential limitations of such an approach

State involvement in interpretation can help guide tribunals in their reading of IIAs, enhancing, amongst others, the predictability of awards. It also proactively clarifies the protective scope of investment treaties for investors and can thus prevent disputes. Moreover, interpretation may be a way to strengthen the public policy dimensions of existing IIAs. For instance, in the context of a recent claim against Australia's plain packaging legislation on tobacco products, it has been suggested that Hong Kong and Australia as contracting parties to the IIA forming the basis of the claim could clarify the meaning of certain treaty provisions to ensure that investment protection does not trump broader public health objectives. It has also been suggested in this regard that an interpretation of the BIT could have retrospective effect and might be relevant for determining the current claim.[17]

While so far, States have rarely given interpretive guidance, this can play an important part in determining the extent of States' commitments under IIAs and to ensure that IIAs reflect the underlying public policy considerations. Compared to complicated and time consuming treaty re-negotiation, modification or denunciation, interpretation may be an efficient option to improve predictability of awards. Interpretive instruments can thus complement better treaty language and other current efforts to remedy the challenges posed by today's IIA regime.

At the same time, State involvement in the interpretation of IIAs can be controversial. Hence, a number of potential limitations need to be considered.

First, States play a dual role in investment law. On the one hand, they are the contracting parties and masters of their IIAs. In that capacity States may provide authentic and authoritative interpretations of their treaties.[18] On the other hand, States may also be respondents in specific ISDS proceedings. Hence, States could potentially use interpretive instruments to influence litigation of ongoing cases to their benefit, raising questions about the equality of arms between the disputing parties. To avoid concerns on abusive interpretations, States may want to issue interpretive statements proactively – in advance – and outside of a particular dispute. However, as the experience from

[13] Ole Kristian Fauchald, «The Legal Reasoning of ICSID Tribunals – An Empirical Analysis», *European Journal of International Law*, Vol. 19, No. 2, 2008, p. 314.
[14] Arsanjani/ Reisman, *supra* note 6, p. 597.
[15] *SGS v. Philippines*, ICSID Case No. ARB/02/6, Decision on Jurisdiction (29 January 2004), para. 116.
[16] *Noble Ventures, Inc. and Romania*, ICSID Case No. ARB/01/11, Award, (12 October 2005), para. 52.
[17] Tania Voon and Andrew Mitchell, «Time to quit? Assessing International Investment Claims against Plain Tobacco Packaging in Australia», Journal of International Economic Law, Vol. 14, No. 3, 2011, p. 529.
[18] See *supra* note 7-10.

NAFTA's Free Trade Commission's interpretation shows (*infra* Box 3), even in ongoing proceedings, tribunals have deferred to the interpretations of the contracting States.

Second, unlike most other international treaties in the economic area, IIAs create rights for individuals. These rights of foreign investors and the legitimate expectations arising thereof could potentially be compromised by subsequent authoritative interpretations by the contracting States. Yet, treaties are not set in stone. States retain the authority to modify or even terminate the IIAs that give rise to investor rights. Similarly investors have to accept that their rights deriving from a treaty may be clarified through subsequent interpretive statements. In any case, legitimate expectations do not protect a specific reading of an IIA provision to the exclusion of other reasonable interpretations.

Third, the interpretation of IIAs has to be distinguished from treaty amendments. Interpretation is in principle confined to clarifying the terms of a treaty and not aimed at filling them with a new meaning. In contrast, amendments may add to or modify existing obligations and they typically require formal adoption, for example, through domestic ratification. In practice, however, the borderline between interpretation and amendment may be blurred.[19] Indeed, international courts and tribunals in the past have accepted interpretations amounting to a *de facto* amendment.[20] It must be noted that such State practice may be highly controversial.

Despite these potential limitations, State involvement in interpretation may, under certain circumstances, offer an efficient and attractive option for States.

# III. Interpretation Rules as a Roadmap for State Involvement

## 1) Interpretation rules under public international law

Interpretation of public international law treaties follows a specific canon of interpretation rules. The most important and widely used canon of interpretation rules is found in Articles 31 and 32 of the Vienna Convention on the Law of Treaties (VCLT) (see Box 1). These rules establish the elements interpreters must take into account when giving meaning to treaty provisions and how to prioritize amongst the different elements.[21] The Convention constitutes a codification of international customary rules on treaty interpretation relevant to all States.[22] In consequence, arbitral tribunals are required to apply the VCLT rules irrespective of whether the contracting States have ratified the VCLT or whether an IIA explicitly provides for the VCLT's application. The rules of interpretation in the VCLT are extensively used by international adjudicating bodies such as the ICJ, panels and the Appellate Body of the World Trade Organization (WTO), and international criminal courts and tribunals.

The VCLT embodies three main approaches to treaty interpretation. Article 31 of the VCLT contains elements of (i) the "textual" school which places emphasis on the "ordinary meaning of the word" and (ii) the "teleological" school which refers to the object and purpose of a treaty. Article 32 partly reflects (iii) the historical "original intention of the parties" approach, but only serves as a supplementary means of treaty interpretation. The primary interpretation rules in Article 31, however, are not hierarchical. They are to be used in a single "holistic exercise" giving weight to all of Article 31's elements (not only the "ordinary meaning").[23] If applied rigorously, the VCLT interpretation rules ensure high legal security and predictability.

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[19] Roberts, Anthea, «Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States», *American Journal of International Law*, Vol. 104, No. 1, 2010, pp. 201-202.

[20] For example, *Legal Consequences for States of the Continued Presence of South Africa in Namibia (South West Africa) Notwithstanding Security Council Resolution 276* (1970), Advisory Opinion (21 June 1971), para. 22. Case concerning the Dispute Regarding Navigational and Related Rights (Costa Rica v. Nicaragua), Judgment of the International Court of Justice (13 July 2009), para. 64,

[21] VCLT Article 31(1) begins with «A treaty *shall* be interpreted...» (emphasis added).

[22] Gardiner, Richard K.,*Treaty Interpretation* (New York: Oxford University Press), 2008, pp. 12ff.

[23] WTO Appellate Body Report, *European Communities – Customs Classification of Frozen Boneless Chicken Cuts* (EC – Chicken Cuts), WT/DS269/AB/R, WT/DS286/AB/R, at para. 176. See also Yearbook of the International Law Commission, 1966, Vol. II, at 219–220.

**Box 1. Articles 31 and 32 of the Vienna Convention on the Law of Treaties**

Articles 31 and 32 codify customary rules of treaty interpretation. Article 31 contains three main elements. The first paragraph underlines the importance of the careful wording of a treaty. It states that treaty terms should be interpreted in accordance with their ordinary meaning and in light of their object and purpose.

The second paragraph of Article 31 refers to the "context of a treaty." This comprises its "text including its preamble and annexes" as well as "any agreement" or "any instrument" accepted by both parties and made in conclusion with the treaty. Hence, by concluding side-agreements, protocols, understandings and other instruments together with the treaty, contracting States can guide tribunals regarding the object and purpose of specific IIA provisions.

The third paragraph of Article 31 deals with the subsequent application of a treaty that may provide further "context" for the interpretation. This includes (a) any subsequent agreement, (b) any subsequent practice establishing agreement between the contracting parties regarding the treaty's interpretation, and (c) any relevant rules of international law applicable between the parties. Therefore, both the evolving practice between the contracting parties as well as the development of the general system of international law applicable to the parties can affect interpretation.

Finally, Article 32 concerns supplementary means of treaty interpretation. This includes but is not limited to the *travaux préperatoires* of the treaty. They may be relevant "to confirm the meaning resulting from an application of Article 31, or to determine the meaning when the interpretation according to Article 31 (a) leaves the meaning ambiguous, or obscure or (b) leads to a result which is manifestly absurd or unreasonable". In these circumstances, the *travaux préperatoires* or any other supplementary means, including even unilateral instruments, may provide helpful guidance for the interpretation of a treaty.

*Source*: UNCTAD.

The VCLT does not entail an exhaustive list of interpretive techniques. Other interpretive rules may be implicitly contained in the VCLT rules, such as the principle of effective interpretation.[24] Some interpretive techniques are not mentioned in the VCLT at all, such as *in dubio mitius* (principle of restrictive interpretation), *expressio unius est exclusio alterius* (express mention of one thing excludes all others) or the *eiusdem generis* (of the same kind) approach.[25] The status of the latter group of principles, however, is subject to some debate. Hence, whereas the VCLT may not be exhaustive, it is the most widely accepted set of interpretation rules.

## 2) Interpretation of IIAs – different stages, different tools

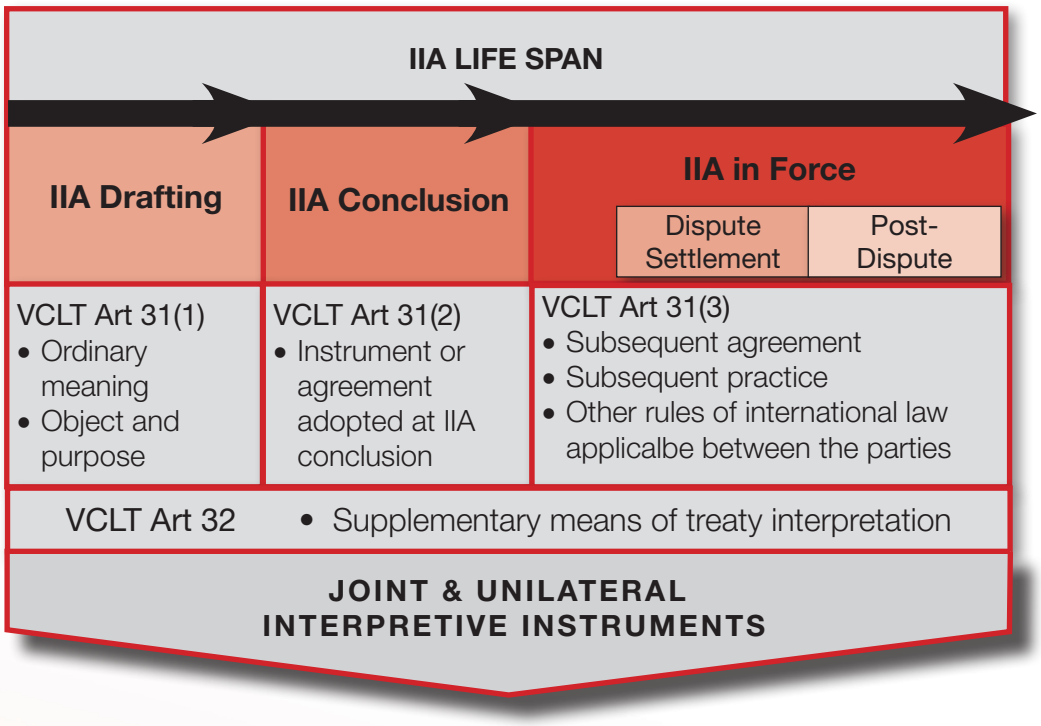
The life of an IIA is characterized by different stages from its drafting over its implementation to its potential application by international arbitral tribunals. At each of these stages, interpretation and tools to guide it play a different role (figure 1).

In the treaty negotiating process, the drafters need to anticipate future interpretations with farsighted and precise treaty language and clear interpretation guidelines. Once the treaty is concluded, the contracting States can clarify the treaty language by issuing interpretive statements and agreements. In addition, States may intervene in dispute settlement proceedings. Furthermore, after the dispute has been decided States can scrutinize arbitral awards and comment on the interpretation by tribunals. Therefore, at every stage States have different interpretive tools at their disposal.

[24] Yearbook of the International Law Commission, 1966, Vol. II, p. 218.

[25] See for instance Schreuer, Christoph, «Diversity and Harmonization of Treaty Interpretation in Investment Arbitration,» in Olufemi Elias, Malgosia Fitzmaurice, and Panos Merkouris (eds.), *Treaty Interpretation and the Vienna Convention on the Law of Treaties: 30 Years On* (Leiden: Martinus Nijhoff Publishers, 2010), pp. 129-151.

**Figure 1. The VCLT is guiding interpretation at every stage in the lifespan of an IIA**




This sequenced approach is supported by the Vienna Convention. The VCLT interpretation rules themselves reflect a distinction between different stages and different tools. In other words, the VCLT provides a roadmap for stage-specific State intervention.

## 3) Interpretation of IIAs: joint and unilateral approaches

IIAs are a product of at least two State parties. In addition to multilateral tools (see Box 2), interpretative tools can accordingly originate from one or several (at least two) State parties.

Joint acts and statements by the contracting parties are considered to be reflective of the intention of all States concerned and, as such, they must be treated as authoritative by subsequent arbitral tribunals.[26] Any agreement or accepted practice, regardless of its legal form[27] (e.g. a joint declaration, an exchange of letters or even verbal notes),[28] establishing consent between the contracting parties as to a treaty's interpretation is to be considered as authoritative.[29] This is reflected in the VCLT rules Article 31(2) and (3)(a) and (b).

In addition, some *unilateral* instruments are available to States such as ratification documents or declarations.[30] States cannot unilaterally give *authoritative* meaning to treaty terms. However, in the absence of conclusive joint interpretations some unilateral documents or statements may provide guidance to arbitrators as supplementary means of treaty interpretation under VCLT Article 32.

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[26] See *supra* note 7-10.

[27] Judgment of the International Court of Justice in the *Kasikili/Sedudu Island (Botswana/Namibia),* Judgement (13 December 1999), I.C.J. Reports 1999, p. 1045, para. 49.

[28] See *Gruslin v. Malaysia,* Award, ICSID Case No. ARB/99/3 (27 November 2000), para. 23.4.

[29] Gardiner, Richard K. *Treaty Interpretation* (New York : Oxford University Press), 2008, pp. 216–220. See also Yearbook of the International Law Commission, 1999, Vol. II, UN Doc. A/CN.4/SER.A/1999/Add.I (Part 2) p. 125, Rule 1.5.3.

[30] See Section IV 2)-5) below.

Some interpretive tools are only available if the contracting parties explicitly provide for them in their IIAs. Examples for such *IIA specific interpretive mechanisms* are treaty-based institutions such as the NAFTA Free Trade Commission or the renvoi procedure giving the tribunal the option to send certain questions back to the contracting parties for interpretation.[31]

# IV. Interpretive Instruments of the Contracting Parties

## 1) Drafting of IIAs

During negotiations, drafters need to consider how a treaty provision may be interpreted in the future. Accordingly, States can provide a clear roadmap for future interpreters both in terms of substance and procedure.

### ➢ Precise wording of treaty provisions

Many IIA provisions are loosely phrased. Recently, however, the drafting of IIAs has gradually gained in precision. In part, this has been prompted by the increase of ISDS proceedings coupled with the States' desire to reduce the margin of discretion for tribunals' interpretation.[32] Farsighted and precise drafting thus plays a crucial role in delineating the discretion of future interpreters hence fostering greater predictability.

One option for negotiators to increase the precision of treaty terms is to supplement broad standards with specific clarifications. Some recent formulations of the provisions on most-favoured-nation treatment (MFN), fair and equitable treatment (FET) and expropriation are illustrative of this trend.[33] Another, related way to avoid tribunals giving broader than intended meaning to certain treaty terms is to include an exhaustive or a negative list. For instance the Canada-Peru BIT (2007) in Article 1 excludes from the definition of "investment" specific assets such as trade financing transactions.[34] Hence, clarity can be enhanced in two ways: (i) by specifying what the treaty obligation entails[35] and (ii) by delineating what is not covered.[36]

### ➢ Reference to rules of treaty interpretation

Governments may also want to clearly state the rules to be followed when interpreting a treaty.

While the VCLT rules apply by default, their inclusion into IIAs through reference may be useful to ensure their rigorous application by arbitral tribunals.

The *Australia-United States* FTA (AUSFTA), for example, provides in Article 21.9 (2) that a panel should "*consider this Agreement in accordance with applicable rules of interpretation under international law as reflected in Articles 31 and 32 of the Vienna*