NEWSLETTER

Balancing Economic Security and Investment Protection, Part II

Dispute Resolution & Competition Law/International Trade Newsletter October 18, 2023

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1. Introduction

On 20 June 2023, the Commission of the European Union ("**EU**") published a proposed "European Economic Security Strategy" ("**Strategy**").[2] This two-part newsletter analyzes the ways in which this new EU policy may affect Japanese businesses and investors in light of the protections afforded to them in the Japan-EU Economic Partnership Agreement ("**EPA**"). In the first part of the newsletter, published on 12 September 2023,[3] we analyzed the Strategy and the EPA. In this second part, after a short introduction on the right to regulate in public international law, we address recent developments in investor-state dispute settlement ("**ISDS**") related to economic security, providing Japanese businesses with an idea of the international recourse they might have against measures taken under the new policy.

2. Right to regulate in international law

The right to regulate in the public interest is understood as a state's right and power to enact legislation with the aim of regulating certain areas affecting the public interest, or of meeting its duty to protect citizens' fundamental rights.

This right is not absolute and must be balanced against a state's international law obligations. As an arbitral tribunal put it, when discussing a state's discretion to regulate in order to safeguard its people's fundamental right to water, "[t]he fundamental right to water and the right of the investor to benefit from the protection offered by the [applicable treaty] operate on different levels: in its sovereignty, the public administration has special powers to guarantee the enjoyment of the fundamental right to water; but the exercise of these powers is not absolute and must, on the contrary, be combined with respect for the rights and guarantees granted to the foreign investor under the [applicable treaty]."[4]

This balance of interests has long preoccupied states, tribunals and academics alike, and the means of

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2 https://ec.europa.eu/commission/presscorner/detail/en/IP_23_3358

3 https://www.nishimura.com/en/knowledge/newsletters/dispute_resolution_competition_law_international_trade_230912

4 *SAUR International SA v. Republic of Argentina*, Decision on Jurisdiction and Liability of 6 June 2012, para. 331 (translated from French).

attaining such an objective has proven to be a complex task.[5] For example, in this pursuit, States are allowed to regulate around certain international law obligations on the basis of national security.

States' ability to rely on security exceptions forms but part of a state's right to regulate, the latter constituting a broader concept. In fact, the existence of a right to regulate in international law, albeit not unconditional, has been widely recognized and accepted by arbitral tribunals in investment arbitration, more so than in the context of WTO dispute settlement, where adjudicators traditionally have not recognized an inherent right to regulate.[6]

3. Relevant precedents in ISDS

In recent years, a number of disputes between foreign investors and states have arisen out of regulatory changes or administrative decisions made in the exercise of states' right to regulate related to national security, affecting foreign investors and their investments.

In a case conducted under the auspices of the Permanent Court of Arbitration, claimants CC/Devas (Mauritius) Ltd., Telecom Devas Mauritius Limited, and Devas Employees Mauritius Private Limited initiated a claim against the Republic of India ("**CC/Devas**").[7] The claimants had invested in an Indian company ("**Devas**") that had concluded a telecommunication agreement with an Indian state entity ("**Antrix**"), operated under the control of the Indian Space Research Organization. Under the agreement, Devas was to lease capacity in the S-Band, part of the electromagnetic spectrum, allowing Devas to build and launch satellites that would host its digital and multimedia technology to provide multimedia services to mobile users across India. The claim arose out of the Indian Government's cancellation of this agreement.

The applicable India-Mauritius Bilateral Investment Treaty ("**BIT**") contained an essential security interest ("**ESI**") clause. The Indian Government asserted that the agreement was cancelled to make the spectrum available for military and other strategic needs, and that its actions were therefore protected by the ESI clause. In deciding whether India could successfully invoke this clause, the tribunal analyzed its wording and found that the absence of a reference to necessity in the wording of the clause gave India a "wide measure of deference" and meant that India did not need to prove that the measure at issue was the only means of protecting an essential security interest. It also did not need to meet the stricter conditions of application of the customary international law notion of state of necessity. Instead, the tribunal analyzed whether the contentious measure was "directed to an essential security interest" and whether there was a genuine need on the part of the military and security agencies of India to reserve S-band capacity.

By a majority, the tribunal found that the contentious measure only was directed "in part" at the protection of India's ESI, but also directed in part at other objectives unrelated to national security. Therefore, the tribunal

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5 Lars Markert, The Crucial Question of Future Investment Treaties: Balancing Investors' Rights and Regulatory Interests of Host States, in: Marc Bungenberg, Jörn Griebel and Steffen Hindelang (eds), *European Yearbook of International Economic Law 2011*, Special Issue: International Investment Law and EU Law (Springer 2011) 150.

6 See Andrew D Mitchell, The right to regulate and the interpretation of the WTO Agreement, *Journal of International Economic Law 2023*.

7 *CC/Devas (Mauritius) Ltd., Devas Employees Mauritius Private Limited and Telecom Devas Mauritius Limited v. India*, PCA Case No. 2013-09.

held that the part which was not reserved for military or paramilitary purposes would be subject to the provisions of the India-Mauritius BIT. Since such part was undefined, and India had already reserved to itself 10% of the spectrum in question, the majority of the tribunal determined that a reasonable allocation of spectrum directed to the protection of India's ESI would be up to 60% of the S-band spectrum allocated to the claimants. The tribunal therefore decided that it lacked jurisdiction over 60% of the claim, but that the contentious measures, insofar as they concerned the remaining 40% of the spectrum allocated to the claimants, fell outside the scope of the ESI clause and were subject to an analysis by the tribunal of compliance with the India-Mauritius BIT.

The tribunal then performed an analysis of whether the portion of the S-band spectrum which was not reserved for military or paramilitary purposes was in breach of the India-Mauritius BIT, specifically whether it constituted (i) unlawful expropriation and (ii) a breach of the fair and equitable ("**FET**") clause.

Regarding the first point, after the tribunal characterized the existence of an expropriation, it found that even if the contentious decision was made for a public purpose, due process had not been followed, and a fair and equitable compensation, which was due, had not been paid. The tribunal thus decided that the claimants were entitled to compensation for the expropriation in proportion to India's decision related to matters other than national security, i.e. up to 40% of the value of their investment. On the second point, the tribunal found that India had breached the good faith requirement under international law and the FET clause of the applicable BIT.

It is interesting to contrast the analysis in CC/Devas with that performed by another tribunal in a case opposing German company Deutsche Telekom and India ("**Deutsche Telekom**"), based on very similar facts.[8] In this case, Deutsche Telekom also had invested in Devas, which had entered into an agreement with Antrix to lease S-band electromagnetic spectrum capacity provided by two orbiting Indian satellites ("**Devas Agreement**"). After the Indian Government approved the annulment of the Devas Agreement ("**CCS Decision**"), Deutsche Telekom initiated an arbitration alleging that India had breached the FET standard under the applicable Germany-India BIT.

The Germany-India BIT contained an ESI clause, which India invoked in this case as well. In order to determine whether the ESI clause could apply, the tribunal in this case looked at whether the CCS Decision was "necessary" to protect an ESI, because the ESI clause in the applicable BIT allowed contracting parties to apply "prohibitions or restrictions *to the extent necessary* for the protection of its essential security interests."[9] To answer this question, the tribunal first analyzed the reasons behind the CCS Decision to characterize the security interest at issue. It found that "a mix of reasons or objectives led to the annulment of the Devas Agreement",[10] including (i) strategic-related concerns together with other "societal needs, such as train-tracking",[11] "disaster management, tele-education, tele-health and rural communication",[12] which fell outside the scope of the ESI clause, and (ii) the impression that Devas did not pay enough for its contractual

8 *Deutsche Telekom v. India*, PCA Case No. 2014-10.

9 Germany-India BIT, article 12 (emphasis added).

10 *Deutsche Telekom v. India*, PCA Case No. 2014-10, interim award, para. 281.

11 *Deutsche Telekom v. India*, PCA Case No. 2014-10, interim award, para. 265.

12 *Deutsche Telekom v. India*, PCA Case No. 2014-10, interim award, para. 281.

rights. While the tribunal recognized that “the so-called strategic needs expressed by the Armed Forces [could] meet the test for essential security interests”,[13] the fact that “societal needs” appeared “side by side with the strategic interests in numerous documents”[14] meant that the interests which were meant to be protected could not be included within the “essential security interests […] without distorting the natural meaning of such term.”[15]

To assess the necessity of the measures to safeguard the state's ESI, the tribunal then examined whether the CCS Decision “principally targeted to protect the essential security interests at stake and was objectively required in order to achieve that protection, taking into account whether the state had reasonable alternatives, less in conflict or more compliant with its international obligations.”[16] Interestingly, the tribunal in Deutsche Telekom did not consider that the requirement to prove that a measure was “necessary” required proving that the measure was the only means of protecting an essential security interest.[17] According to the tribunal in Deutsche Telekom, “essential” security interests are those “that go to the core (the ‘essence’) of state security.”[18] Similarly, in CC/Devas, the tribunal had found that India, "[did] not have to demonstrate necessity in the sense that the measure adopted was the only one it could resort to in the circumstances", possibly because the ESI clause in the India-Mauritius BIT did not include a requirement of necessity to display its effects.[19] Nevertheless, the tribunal in CC/Devas held that India had to show that the security interest which India was seeking to protect was “important (…) absolutely necessary, indispensably requisite (…) unavoidable”,[20] a test that seems equally difficult to meet as the “necessity” requirement.

Ultimately, in Deutsche Telekom, the tribunal came to the conclusion that India had “not established that its measure [] was necessary for the protection of its essential security interests.”[21] The tribunal therefore applied the BIT's substantive standards and found that the contentious measure was arbitrary and lacking transparency, and in breach of the FET obligation under the Germany-India BIT. India challenged the Award before the Swiss Federal Supreme Court, but in vain.

In CC/Devas and Deutsche Telekom, the respective tribunals defined different thresholds to decide whether the disputed measure could be considered to be a legitimate exercise of the respondent’s right to regulate to protect an essential security interest. However, the common pattern established might guide tribunals constituted in present or future cases in their appreciation of states’ right to regulate.

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13 *Deutsche Telekom v. India*, PCA Case No. 2014-10, interim award, para. 281.

14 *Deutsche Telekom v. India*, PCA Case No. 2014-10, interim award, para. 281.

15 *Deutsche Telekom v. India*, PCA Case No. 2014-10, interim award, para. 281.

16 *Deutsche Telekom v. India*, PCA Case No. 2014-10, interim award, para. 239.

17 *Deutsche Telekom v. India*, PCA Case No. 2014-10, interim award, para. 229.

18 *Deutsche Telekom v. India*, PCA Case No. 2014-10, interim award, para. 236.

19 *CC/Devas (Mauritius) Ltd., Devas Employees Mauritius Private Limited and Telecom Devas Mauritius Limited v. India*, PCA Case No. 2013-09, award on jurisdiction and merits, para. 243.

20 *CC/Devas (Mauritius) Ltd., Devas Employees Mauritius Private Limited and Telecom Devas Mauritius Limited v. India*, PCA Case No. 2013-09, award on jurisdiction and merits, para. 243.

21 *Deutsche Telekom v. India*, PCA Case No. 2014-10, interim award, para. 291.

First, both tribunals agreed that the ESI clauses were not "self-judging" clauses, which means that states cannot, at their own discretion and without tribunals' oversight, determine what they consider necessary for the protection of their security interests, unless the ESI clause expressly grants them this power.[22]

Second, both tribunals gave importance to the wording of the ESI clause contained in the applicable BIT,[23] and they agreed that there was no objective requirement of "necessity" to ESI clauses.[24] The reason why the tribunal in Deutsche Telekom sought to establish necessity to give effect to the ESI clause was because it read an express requirement of necessity into the wording of the ESI clause itself.

Third, while the tribunals disagreed on whether the mere availability of a resource suitable to accommodate military needs could constitute an ESI, they agreed that the availability of such a resource for non-military needs, and instead for public utility services, could only be considered an issue of public interest and therefore could not constitute an ESI.[25] It remains to be seen whether future tribunals assessing the scope of "essential security interest" consider it to encompass matters beyond military needs.

This distinction could become relevant in a dispute opposing Chinese company Huawei and the Kingdom of Sweden. The Swedish telecommunications regulator banned Huawei as well as another Chinese company, ZTE, from supplying 5G equipment to Swedish mobile firms. The Swedish regulator cited "security risks" and expressly asserted that China might spy on internal communications within Sweden via equipment used by the aforementioned companies. After Huawei unsuccessfully sought remedies before domestic courts to lift the ban, it filed a Request for Arbitration against Sweden under the China-Sweden BIT on 7 January 2022.[26]

Sweden filed a request for bifurcation on the basis that Huawei had not established that it had a "categorical right for [its] products to form part of the architecture of the New 5G Networks."[27] Among others, it would have had to conclude framework contracts with Swedish mobile network operators which "could only deploy 5G network services after undergoing a licensing process within the exclusive control of the State".[28] To address this matter, the tribunal noted that "the Claimant's case is not limited to claims concerning Sweden's 5G networks," but also extends to "the alleged effects of Sweden's measures on the Claimant's current and/or future undertakings in Sweden regarding inter alia 4G, 6G, and 7G technologies, as well as fixed-line

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22 *CC/Devas (Mauritius) Ltd., Devas Employees Mauritius Private Limited and Telecom Devas Mauritius Limited v. India*, PCA Case No. 2013-09, award on jurisdiction and merits, para. 219; *Deutsche Telekom v. India*, PCA Case No. 2014-10, interim award, para. 231.

23 *CC/Devas (Mauritius) Ltd., Devas Employees Mauritius Private Limited and Telecom Devas Mauritius Limited v. India*, PCA Case No. 2013-09, award on jurisdiction and merits, paras. 230-241; *Deutsche Telekom v. India*, PCA Case No. 2014-10, interim award, paras. 225-229.

24 *CC/Devas (Mauritius) Ltd., Devas Employees Mauritius Private Limited and Telecom Devas Mauritius Limited v. India*, PCA Case No. 2013-09, award on jurisdiction and merits, paras. 229-241; *Deutsche Telekom v. India*, PCA Case No. 2014-10, interim award, paras. 228 and 229.

25 *CC/Devas (Mauritius) Ltd., Devas Employees Mauritius Private Limited and Telecom Devas Mauritius Limited v. India*, PCA Case No. 2013-09, award on jurisdiction and merits, paras 354-361; *Deutsche Telekom v. India*, PCA Case No. 2014-10, interim award, paras. 236 and 281.

26 *Huawei v. Sweden*, ICSID Case No. ARB/22/2.

27 *Huawei v. Sweden*, ICSID Case No. ARB/22/2, Procedural Order No. 3 ("**PO3**"), para. 13.

28 *Huawei v. Sweden*, ICSID Case No. ARB/22/2, PO3, para. 13.

networks."[29]

In this case, the Swedish telecommunications regulator applied a restrictive measure to Huawei specifically, as opposed to adopting a measure of general application aimed at protecting the security of its 5G network more broadly. It will be interesting to observe how the arbitral tribunal will take this fact into account in its legal analysis.

Huawei also was subject of measures brought about by the UK regulator. In 2020, the UK banned the purchase of new Huawei 5G equipment and decided that all Huawei equipment would have to be removed from 5G networks by the end of 2027. This decision was made following advice produced by the National Cyber Security Centre on the impact of US sanctions against the telecommunications vendor. The UK Government claimed that "[t]he policy in relation to high risk vendors has not been designed around one company, one country or one threat. It is intended to be an enduring and flexible policy that will enable us to manage the risks to the network both now and in the future."[30]

Huawei submitted a notice for arbitration against the UK in October 2022, and it appears that counsel has been appointed in anticipation of likely arbitration proceedings between Huawei and the UK.

While these cases are still ongoing, it will be crucial to follow their outcome and to understand the degree of deference that arbitral tribunals will consider they owe states in determining what forms part of their right to regulate. It will also be interesting to observe how much weight a future arbitral tribunal will give to the UK Government's statement that the policy "has not been designed around one company, one country or one threat".

As the cases against India show, arbitral tribunals faced with claims arising out of measures taken in application of states' right to regulate respected regulatory discretion in principle. However, arbitral precedent will have made states aware that the exercise of such right cannot apply unconditionally. States cannot use the right to regulate as a blanket defense which excuses any and all breach of a BIT. When such a defense is asserted, tribunals will closely analyze the wording of the BIT, the importance of the security interest being protected, and how close the link is between the measure and the security interest that is allegedly being protected. While it is difficult to predict how and to what extent tribunals will show deference on the states' right to regulate, the aforementioned elements will likely serve as guidance in future cases.

3. Conclusion

In light of the current geopolitical climate, states are increasingly legislating to protect national security interests. At the same time, there exist limits to host states' right to invoke national security exceptions and more broadly, their right to regulate. ISDS practice has started to lay the foundations of ways in which tribunals seek to strike a balance between the right to regulate and the promotion of foreign investment, but many questions remain, the answers to which might be decided soon in the context of disputes which have recently arisen. These upcoming decisions might prove central in shaping the extent to which host states may exercise their right to

[29] *Huawei v. Sweden*, ICSID Case No. ARB/22/2, PO3, para. 44.

[30] Press release from the UK Department for Digital, Culture, Media & Sport published on 14 July 2020, accessible at this link.

regulate and their national security exceptions. ISDS may thus grow into a form of global governance that involves the exercise of judicial power by arbitral tribunals in the global administrative space. For these reasons, we recommend that Japanese businesses stay attentive to new regulations and ISDS trends, even if their businesses are not directly or expressly targeted.

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