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**Negotiating Group on the Multilateral Agreement on Investment (MAI)**

**NATIONAL SECURITY MEASURES**

**(Note by the Chairman)**

## NATIONAL SECURITY MEASURES

(Note by the Secretariat)

### **I. Introduction**

1. It is a common feature in international agreements to recognise the rights of sovereign nations to take measures, notwithstanding the obligations undertaken in a particular agreement, to protect their essential security interests. There is no internationally recognised definition of essential security interests and "general exception" articles sometimes also provide for measures taken to preserve or maintain "public order" and/or "international peace and security". This note is primarily concerned with the more narrow interpretation of "essential security interests" or "national security interests" as those affecting the defence and safety of the state.

2. As requested by the Negotiating Group (see Summary Record, [DAFFE/MAI/M(95)2]) this note summarises the experience of Member countries with the application of essential security concepts under the existing instruments and looks at the scope of articles relating to general exceptions or essential security interests in recent international agreements with a view to identifying possible limitations. The relevant extracts from the agreements referred to in the note are reproduced in "Selected Articles from existing investment instruments: national security" [DAFFE/MAI/RD(95)16].

### **II. Application of essential security concepts: OECD Experience**

3. The OECD investment instruments expressly recognise a Member's right to take actions necessary to protect its essential security interests. While the provisions in the Codes of Liberalisation and the Declaration on International Investment and Multinational Enterprises are substantially the same, the Codes (article 3) also refers to measures for the protection of public health, morals and safety.

4. These provisions are broad, but they are accompanied by procedures of clarification, transparency and peer review aimed at limiting abuses and achieving greater consistency in the manner that Members apply the provisions to particular measures. The CMIT and CIME Committees have made considerable efforts over the past few years to improve the transparency of government measures and practices motivated by essential security interests in Member countries. The Organisation has served as a forum for consultations and examination of particular measures which have been brought to its attention. In some cases, the Council has issued recommendations to certain countries where there have been concerns that national security provisions might go beyond what was strictly necessary.

5. Under the National Treatment instrument (NTI), Member countries must notify the Organisation of measures relating to their security interests which are reported for transparency purposes. In 1985, the CIME conducted a thorough examination of recourse to such measures by Member countries in the context of National Treatment. The Committee recommended that those Member countries which have measures based on public order and essential security interests may wish to consider the practice and experience of other Member countries which have no such measures yet have similar concerns relating to public order and essential security interests.

6. The 1991 Review of the National Treatment instrument tightened the clarification relating to public order and essential security interests by making clear that measures taken for economic, cultural or

other reasons, for example, should be identified as such and should not be shielded by an excessively broad interpretation of public order and essential security interests. The CIME also concluded that Member countries should reduce to a bare minimum the number of measures classified as being motivated by public order and essential security interests. To this end, the Chairman of CIME wrote to delegations indicating particular measures where it would be in line with the sentiment of the Committee to record these measures as exceptions. A number of Member countries reclassified various transparency measures as exceptions at that time.

7. Although measures relating to public order and the protection of essential security interests are not the subject of reservations to the Codes, they have long been included in the periodic country examinations carried out by the CMIT. The CMIT tightened the interpretation of Article 3 by providing that these measures should not be such as to frustrate effective liberalisation. These measures are now included in the examinations jointly conducted by the CIME and the CMIT. Transparency is further ensured by the CMIT's periodic publication on the controls and impediments affecting inward direct investment in OECD Member countries, the latest version of which appeared under the title *Foreign Direct Investment: Policies and Trends in the OECD Area during the 1980s* (OECD, 1992).

8. The CMIT also serves as a forum for consultations on specific measures taken by individual countries. As a result of one such extensive review, the CMIT decided to conduct a comparative survey on the practical application by Member countries of Article 3 of the Codes, which was carried out jointly with the CIME in order to take up National Treatment measures based on national security. (See annex to this note for a summary of the survey.)

### **III. Essential Security Provisions in International Investment Agreements**

#### **i) Scope of Provisions**

9. While some agreements have a specific national security clause, others include national security in general exceptions provisions applying also to public order. An analysis of these provisions in recent investment agreements indicates a trend towards narrowing the national security concept as traditionally found in earlier agreements. Articles dealing with essential security interests, *stricto sensu*, exclude any reference to public order exceptions (Article 2102 NAFTA, Article 10 Shipbuilding Agreement<sup>1</sup>). They might also link essential security interests to specific actions in time of war, supplying of military establishments, protection of information contrary to a Party's essential security interests, nuclear non-proliferation obligations, etc. (Article 2102 NAFTA, Article XIV bis GATS, Article 24 (3) ECT, Article 10 Shipbuilding Agreement).

10. In addition, the ECT and the GATS treat general exceptions (Article XIV GATS, Article 24 (2) ECT) separately from essential security interests allowing for more stringent conditions to apply to general exceptions than to essential security exceptions (see section iii), below).

11. As concerns international peace and security, the ECT is the only recent investment treaty which does not refer to actions taken in pursuance of obligations under the UN Charter for the maintenance of

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<sup>1</sup>The full title of this agreement, signed in December 1994, not yet in effect, is the OECD Agreement Respecting Normal Competitive Conditions in the Commercial Shipbuilding and Repair Industry. For convenience, this note refers to the "Shipbuilding Agreement".

international peace and security. The question arises whether the non-inclusion of such a clause could negatively affect Members' international obligations under the UN Charter.

12. Most bilateral investment treaties<sup>2</sup> do not include provisions for measures taken to protect essential security interests. Since right of establishment or entry of investment is usually subject to the laws and investment policies of the host country, security considerations are presumably addressed in that context. As the scope of the treaties is generally limited to the protection of established investment, countries concluding these treaties may not wish to allow for national security exceptions for the obligations most commonly contained in these treaties, i.e., national treatment/mfn, compensation, expropriation, transfer of funds, etc.

13. Two notable exceptions are the German and US model BITs. The US model treaty (Article XIV) contains a general exception for measures to maintain international peace and security and to protect essential security interests. It should be recalled that the US practice in this area is to conclude treaties with obligations also on pre-establishment. The German model (additional protocol article 3) stipulates that measures taken for public security and order, public health or morality shall not be deemed "treatment less favourable"; but this is limited as applying only to article 3 of the main treaty which deals with national treatment/MFN obligations.

#### ii) Non-Application to certain obligations

14. Unless provided otherwise in the agreement, general exceptions or national security provisions apply to all of the substantive obligations and commitments. The only example of a multilateral agreement which does not allow for national security exceptions to be taken with regard to specific obligations is the ECT (Article 24 (1)) which excludes exceptions from applying to obligations under Articles 12 [Compensation for losses], 13 [Expropriation] and 29 [Interim provisions on TRIMS]. Similarly, the general exception provision in Article 24 (2) (i) of the ECT relating to measures necessary to protect human, animal or plant life or health does not apply to the investment provisions (Part III) of the Treaty.

15. On the basis of BIT experience, it is for consideration whether investment protection provisions for post establishment need to be covered by national security clauses.

#### iii) Other Limitations

16. Traditionally, the right of a country to invoke an exception for actions taken in pursuance of its essential security interests is without qualification. There is a commonality of expression, particularly as concerns essential security interests, which recognises that a party may take any action which it considers necessary to protect these interests. This language confers a large degree of "self-judgement" on the party invoking the exception and makes challenge by another party that feels itself aggrieved by such action difficult. Recent investment agreements, however, have made some attempts to limit the possibility of abusive recourse to general exceptions provisions, or to essential security provisions. While these limitations generally reduce the scope of the provisions, and in some cases might limit their "self-judging" nature, the implications of these limitations are not entirely clear.

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<sup>2</sup>This analysis includes only eight Member countries' model bilateral investment treaties (Australia, Canada, France, Germany, Netherlands, Switzerland, United Kingdom, and the United States), Member countries are therefore invited to comment on their bilateral treaty practice with regard to measures relating to national security.

-- General exceptions provisions

17. Both the ECT (Article 24 (2)) and the GATS (Article XIV, chapeau) introduce a requirement that such measures shall not constitute, or be applied in a manner which would constitute, arbitrary or unjustifiable discrimination. In addition, the measures may not serve as "disguised restrictions". The ECT further provides that such measures shall not nullify or impair any benefit one or more Party may expect under the Treaty.

-- Essential security provisions

18. The GATS qualification noted above is not carried over to the security provisions of the GATS per se (Article XIV bis), so that as concerns national security, the measures remain entirely "self-judging".

19. The ECT's qualification is found in much more narrow scope in its provisions dealing with essential security and public order. It requires only that such measure "shall not constitute a disguised restriction on Transit" (Article 24(3)). The Shipbuilding Agreement also introduces a limitation to the security exceptions article which provides that measures or practices with regard to security interests may not constitute "disguised actions taken in favour of the commercial shipbuilding and repair industry...".

iv) Transparency, consultation and peer review

20. Unlike the OECD instruments which have developed in-depth procedures to provide for transparency, consultation and peer review, there does not appear to be a similar mechanism in any of the recent investment agreements to systematically collect and examine information relating to measures taken under general exceptions or essential security provisions.

21. These agreements all contain transparency requirements designed to provide the investor with information concerning measures relating to the particular agreement. The transparency clauses concerning notification and publication of relevant measures do not refer specifically to measures taken pursuant to general exceptions or essential security provisions; hence these requirements will not capture either measures. Furthermore, the essential security provisions exclude anything in the agreement from being construed as an obligation on the part of any member to furnish any information, the disclosure of which it considers contrary to its essential security interests (Article XIV bis GATS, Article 2102 NAFTA, Article 10(1)(a) Shipbuilding Agreement).

v) Dispute settlement

22. The question was raised at the Negotiating Group of allowing recourse to dispute settlement by a party that is of the opinion that another party has abused the provisions of a national security article. While several recent agreements might introduce a limit to the otherwise "self-judging" nature of the provisions on general exceptions (ECT, GATS), or national security exceptions (ECT), it is not clear whether this would give rise to an actionable claim on the part of the complaining party. The fact that the qualification is included in the article would argue in favour of such an interpretation. If the interpretation was that such a claim was actionable, it should be recalled that the GATS only provides for state-to-state dispute settlement and that as concerns investment matters, the ECT only covers (at least provisionally) post-establishment obligations.

23. The Shipbuilding Agreement does provide more clarity in this respect. Under Article 10, paragraph 2, a Party who is of the opinion that another Party has misused this Article may, ... "without prejudice to its right to initiate the other procedures foreseen in this Agreement, request further clarification." The other Party is under the obligation to provide ...."the available information as fully and quickly as possible....". The "other procedures" foreseen in the Agreement include the Parties' Group mechanism or binding dispute settlement for improper subsidies.

## ANNEX

1. The Public Order and Security article in the OECD Codes of Liberalisation (Article 3) allows a Member country to take action which it considers necessary for the maintenance of public order or the protection of public health, morals and safety; the protection of its essential security interests; and the fulfilment of its obligations relating to international peace and security. The National Treatment instrument (II.1) commits Member countries to provide National Treatment to other Member countries consistent with their needs to maintain public order, to protect their essential security interests and to fulfil commitments relating to international peace and security.
2. The experience of Member countries with the application of these concepts in the existing instruments was recently reviewed in the Secretariat note "A Review of Measures and Practices Relating to Public Order and Essential Security as they Affect Foreign Direct Investment" [DAFFE/INV/IME(95)31]. This joint study by the CIME and CMIT was based on Member countries' replies to a questionnaire on the various methods used to ensure the maintenance of public order and the protection of essential security interests. The information was supplemented by individual OECD Reviews of Foreign Direct Investment for a number of countries, as well as by the publication on National Treatment for Foreign Controlled Firms. The purpose of the review was to improve the transparency of measures relating to essential security and public order.
3. Various direct measures were found to be important, including:
  - (1) trans-sectoral screening mechanisms related specifically to national security.
  - (2) residency or nationality requirements for the board of directors. When national security is concerned, these requirements usually concern specific firms or one sector such as that producing defence material. The justifications given for the measures are the need to protect essential security and public order.
  - (3) sectoral measures which vary greatly in their scope.
    - a) authorisation for the production and transit of defence material.
    - b) restrictions on foreign participation in a range of sectors, including nuclear energy, telecommunications, air or maritime transport (both cabotage and foreign ownership), broadcasting, gaming, hydropower, pipelines, petroleum, aerospace and agriculture.
    - c) restrictions on the purchase of real estate in sensitive areas.
  - (4) government procurement policies which restrict access of foreign-controlled firms to contracts involving sensitive material or procurement for the military or in sectors deemed sensitive such as communications.
  - (5) government subsidies and aids which are limited only to national firms

4. In addition, a number of potential indirect measures were identified, including trans-sectoral general screening mechanisms and residency or nationality requirements for the board of directors or managing director of firms, sectoral measures not specifically related to essential security, and the existence of public monopolies.

5. No clear definition of the sectors most relevant to essential security emerged, with some countries maintaining broad trans-sectoral measures while others adopted more narrow sectoral ones. It was found that six Member countries imposed sectoral restrictions which were not present in any other country. In five cases, a sector was only mentioned by two Member countries. In many of these sectors, other Member countries maintained no restrictions on any basis.

6. In other sectors, however, countries report such restrictions on some other basis than essential security. Most countries, for example, list both air and maritime transport as exceptions to national treatment. Three countries list maritime transport under "other measures reported for transparency". In other sectors, such as telecommunications or nuclear energy, foreign participation is restricted by the presence of public or private monopolies.