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PRECEDENTS IN INVESTOR STATE ARBITRATION

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ARTICLE 102 AND HIGH TECHNOLOGY INDUSTRIES: THE IMPACT OF THE EUROPEAN MICROSOFT AND INTEL CASES

MICHAEL REYNOLDS AND MICHELLE CHOWDHURY

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INTRODUCTION

After two fulfilling years and two successful issues, in the third year of its existence, the Indian Journal of International Economic Law has sought to build upon its strengths and broaden its profile. IJIEL is proud to have been the first third world perspective on international economic law in India, and continues to be proud of its efforts to contribute to this area of law. Amongst the many steps we have taken this year, two in particular are worthy of special mention.

The first was the first IJIEL International Student Essay Competition. The theme for the essays was ‘TRIPS-plus Obligations and Free Trade Agreements with Developing Countries’, and the competition was judged by Profs. Carlos Correa and Daniel Gervaise. Over 40 undergraduate students from around the world registered their participation. The second was the IJIEL Special Issue on Space Law and International Economic Law. The issue consists of five articles on different economic and commercial aspects of international space law, an area that, in our estimation, was not only relatively unexplored, but also of great interest and importance.

Through these and other efforts, this year’s Student Editorial Board has endeavoured to engage in a discussion of international economic law that may succeed in increasing interest in and access to, international economic law for students everywhere. This effort has carried through into the contents of this issue.

In ‘Managing India’s Foreign Exchange Reserve: an Exploration of the SWF Temptation’, Julien Chaisse, Debashis Chakraborty and Jaydeep Mukherjee analyse sovereign wealth funds, their working and their obstacles, focusing specifically on the domestic and foreign challenges facing Indian SWFs.

Akshay Kolse Patil examines the applicability of the doctrine of *stare decisis* in investor-state arbitration, arguing in favour of the existence of a limited but powerful *de facto* rule of precedent.

Dr. A. Jayagovind, Member of the Board of Editors of IJIEL, contributes a guest article on the ‘Anti-Dumping Agreement and Exhaustion of Law
Remedies’, where he seeks to examine the applicability of the international law doctrine of ‘exhaustion of local remedies’ in international economic law, and specifically under the Anti-Dumping Agreement. Dr. Jayagovind concludes that current practice reveals a worrisome trend of immediate resort to the WTO’s Dispute Settlement Mechanism.

The last full length article in this issue is the winner of the 1st IJIEL International Student Essay Competition. In ‘TRIPS through the Lens of Global Public Goods: Are TRIPS-plus FTAs eating up all the Good there is?’, Ishupal Singh Kang analyses TRIPS-plus obligations in FTAs with developing countries from the global public goods perspective. This is the first article written by an undergraduate student that is being published by IJIEL.

Concluding the issue is a case study-based analysis of the European Commission’s application of competition law to high technology industries: ‘Article 102 and High Technology Industries: the Impact of the European Microsoft and Intel Cases’, by Michael Reynolds and Michelle Chowdhury. In light of recent investigations initiated against Google, this is definitely going to be an area of increasing interest and concern.

The student editorial board of IJIEL must express its gratitude to our board of editors, our faculty advisor – Dr. Jayagovind, and our patron and sponsor – Mr. Rajiv Luthra and Luthra & Luthra Law Offices, without whom none of our plans could have achieved fruition.

Abhimanyu George Jain
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FOREWORD

Perhaps it is not a coincidence that the third volume of the Indian Journal of International Economic Law addresses issues of both trade and investment – with the latter being predominant. Traditional issues of trade regulation are the topic of the paper on exhaustion of remedies in anti-dumping procedures. The papers on precedents in investment disputes and on sovereign wealth funds relate to the problem of foreign direct investment. The contribution addressing intellectual property and the issue of TRIPS-plus obligations equally does so, as both protection of intellectual property and the regulation of services in GATS inherently address investment. The same is true for competition law where trade and investment intrinsically merge.

Trade regulation dominated the ascent of international economic law in the first decade following the conclusion of the Uruguay Round in 1995. It placed this field at the heart of international law thanks to WTO dispute settlement and the impressive proliferation of case law of panels and the Appellate Body. Current work and scholarly interests pay considerable attention to investment issues. The present papers offer a welcome contribution to this debate which needs to carefully address the interface of trade and investment protection. The two fields increasingly overlap on substance while following entirely separate procedural structures.

The past and current differences between the two fields are striking. While trade disputes are framed by a multilateral order and transparency, investment disputes continue to follow the traditions of 19th century ad hoc arbitration. Neither transparency nor legal security is secured, given that there are more than two thousand bilateral investment protection agreements. Although they overlap, they do not share a common language or common standards. The possibility for private companies to directly challenge governmental regulations and action amounts to the most prominent feature and explains the attractiveness of this avenue. Yet, the appointment of arbitrators is often not transparent, and the role of precedents is not settled. The companies involved often do not wish to share the outcomes with the public, contributing to the law as a public good. For many years, access to decision and rulings
was accidental. Yet, the most important differences relate to substantive law. While trade rules seek an appropriate balance between trade and non-trade concerns in the process of progressive liberalization and regulation, refined in WTO dispute settlement, investment protection agreements primarily aim at serving the needs and interests of investors. For those affected, the costs can be high: governments are increasingly engaged in costly disputes, seeing policy space in domestic policies reduced and threatened. Most of the agreements do not provide exceptions for non-economic concerns comparable to those within the WTO. People affected by and large depend upon governments to defend their interests and property rights; often they see themselves without appropriate remedies. The recent shift in foreign direct investment from flows to the South to flows to the North, and the new phenomenon of large-scale investment by emerging economies in particular in Africa, calls for a review of the traditional foundations of investment protection law. There is a need to broaden the scope of interests taken into account, ranging from non-economic goals to property rights and human rights. There is a need to take into account environmental concerns, in particular those relating to the complex regulatory issues of climate change. There is a need to find ways and means to prevent disputes arising in the first place and to reinforce the bargaining tools not only for those benefitting, but also for those being affected, by foreign direct investment.

The task ahead consists in bridging the conceptual gaps between trade and investment, and in bringing about greater coherence between these two main fields of international economic law. It is pleasing to see that the Indian Journal of International Law has embarked on this journey. It can play an important role in the upcoming debate.

Professor Thomas Cottier
Managing Director
World Trade Institute, University of Bern, Switzerland
Managing India’s Foreign Exchange Reserve: An Exploration of the SWF Temptation

Julien Chaisse, Debashis Chakraborty and Jaydeep Mukherjee

ABSTRACT

Despite increasing inclination towards market liberalization and privatization observed over the last decade, the role of States has, in this period of time arguably grown in importance in some particular aspects of investment. Notably, investments from emerging economies have increased, and a large proportion of which was executed by State-owned enterprises (SOEs) and sovereign wealth funds (SWFs). Both forms of investments originate from State ownership and State activity, and are thus regularly referred to as investments by “state-controlled entities” (SCEs).

Investment through the SWF route is not a recent phenomenon, but has been in operation for around five decades. The purpose of SWFs is to invest surplus State reserves in foreign currency to yield profits. The funds improve the liquidity of the financial markets, create long term growth and jobs and ensure stability for the companies they invest in. These responsible and reliable investors have pursued a long-term, stable policy that has certainly stood the test during the recent turmoil in the financial markets.

SOEs are particularly important in emerging and transitioning economies such as China, India, Vietnam, Singapore, Malaysia, Czech Republic and Russia. Many SOEs are listed on the Fortune Global 500 list. Chinese SOEs figure most frequently in this listing, and count for 24 spots on the same. Due to the significance of foreign direct investment by Chinese SOEs, their characteristics have received particular attention. By far the largest outward investments by

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2 The recent economic crisis is however underlining the role to be played by the national Governments in no uncertain terms.
Chinese MNEs are made by SOEs, and all investment projects follow a scheme that ensures that they are strictly in line with government policies. The motivations of Chinese firms to internationalize and the government interest in this effort are to a large extent aligned and institutionally intertwined.

This paper attempts to analyse the trends in SWF investment and the main obstacles they face. In particular, the analysis focuses on the major potential challenges for Indian SWFs, in case they come into existence. The analysis is arranged along the following lines. First the global SWF experience is reviewed, followed by the possibility of creating Indian SWFs. The subsequent analysis intends to identify the main regulations in the EU and the US markets that Indian SWFs might face. These regulations might function as potential obstacles in the sense that they incorporate conditions for any investment to enter their domestic markets. The analysis will then focus on the multilateral (IMF) guidelines on SWFs, which might, as well be perceived as an obstacle. However complying with these multilateral rules could be advantageous for Indian SWFs, if these regulations help them to avoid the EU and US obstacles to investment. On the basis of the analyses with respect to legal perspective, the policy conclusions on Indian investment strategies are drawn.

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4 The IMF principles detailed below are not regulations in the strict sense of the term but rather they offer guidelines covering governance, accountability, transparency, and conduct of investments for SWFs.
I. Trends in Sovereign Investments in the World

SWFs can be defined as pools of investment capital (whatever may be the legal form of the SWF: private or public) controlled by a government or central bank and invested in economic activities in other countries. The source of this capital is foreign exchange reserves, which all governments keep (typically in widely traded currencies such as the Dollar, Euro, or Yen). When there is a surplus current account balance those reserves can be put into an investment fund and used to increase national wealth or diversify sources of revenue.

Sovereign wealth funds have come into the spotlight, especially since 2007 when China declared its intention to invest USD 3 billion of its fund reserves in private holding companies. The SWFs have raised concerns about financial stability, corporate governance, and political interference and protectionism. Interestingly, it is observed that the funds for many Merger and Acquisition (M & A) transactions originate from potential geopolitical rivals. Currently SWFs and central banks with a large SWF function manage an estimated USD 3.2 trillion of assets.

It is however important to put SWFs into perspective with other existing investment options. In 2006, by comparison, global stock market capitalisation was USD 42 trillion, while the market value of private debt securities was USD 23 billion. The importance of SWFs in global capital markets is expected to grow, mainly because of high oil prices, the relative weakness of the US dollar and the persistent current account surpluses in China and certain other Asian countries. The idea here is that a country can establish its SWF only if

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5 It should be borne in mind that SWFs usually lack structures that are transparent and management processes that are domestically and internationally accountable. They work in an opaque way. SWFs do not publish statistics on their composition and size or their investments and strategies. Another concern is that management of SWFs may be motivated by “nationalistic considerations” and not only made in search of investment opportunities that yield optimal risk-adjusted rates of return as suggested by classical economic theories. See J. Chaise and P. Gugler, Investment Regulation: Is Fragmentation further Increasing in the Light of Emerging Investment Issues? The Fragmentation of International Trade Regulation – 12 Essays on Achieving Coherence (T. Cottier et al. eds., 2010).

it has surplus foreign currency. Looking at the data on SWFs it is observed that the surplus is generated through two channels. On one hand, UAE, Saudi Arabia, Kuwait, Norway, Russia etc. set up SWFs from their oil revenue. On the other hand, the SWFs of China, Singapore, Australia, New Zealand etc. depend on their non-commodity export earnings.

In 2007, Morgan Stanley predicted that SWFs may manage USD 12 trillion by 2015. Global Insight announced in 2008 that SWFs have been growing by 24 per cent annually for the past three years. Projecting from this annual growth rate, Global Insight forecasted that SWFs will surpass the entire current economic output of the United States by 2015, and that of the European Union by 2016. In 2010, Preqin Special Report on Sovereign Wealth Funds gave an updated assessment of SWF growth. The start of a global economic recovery has helped the aggregate assets under management of all SWFs to reach $3.59 trillion, which represents a 11% increase from last year. The picture is striking- despite the global economic and financial crisis, SWFs have retained their influence.

As a result of the financial crisis, the US market remains an attractive option for the emerging economy SWFs (especially China). This has become a matter of concern there, the most prominent being the fear of foreign government investment for the wrong reasons like threatening national security. The concerns expressed in the US are known and shared by the EU. Owing to the geographic proximity, however, Europeans are perhaps more concerned about Russia. This explains to some extent the different perceptions on the two sides of the Atlantic and the differences in terms of regulatory approach.

Four issues are generally important in relation with SWFs. First, the role of investing governments is often called into question. Second, the lack of transparency of SWFs is another area of concern. Third, the alleged political motivations behind SWF operations represent a major clash. Finally, from a political economic standpoint, there is certainly a difficulty for developed countries in accepting a shift in the balance of power in the world economy to new emerging market giants.

7 The data is obtained from Sovereign Wealth Fund Institute, http://www.swfinstitute.org/funds.php.
9 The details can be obtained from http://www.globalinsight.com/.
10 See Preqin, Special Report on Sovereign Wealth Funds 190 (2010).
A. Towards An Indian SWF?

The idea of an Indian SWF was not conceivable in the eighties or the nineties, owing to the relatively low level of overall foreign exchange reserve (FER) of the country and the consistent adverse current account balance during that period. The overall level of FER was quite low and fluctuating in the eighties. Owing to this reason, investment outflow was never actively encouraged. The situation reached an all time low in 1989-90 with an FER of USD 3962 Million. The FER scenario improved to some extent with increase in gold reserves in the next year, but the foreign currency asset holding declined, which offset the effect partially. The transition towards an outward-oriented economic policy was adopted subsequently, which resulted in an increase in FERs, but has been followed by a simultaneous decline in India’s Special Drawing Rights (SDRs) reserves since then. India’s FER scenario is graphically represented below in Figure 1.

Figure 1. India’s Nominal and Real Foreign Exchange Reserves from 1990-91 to 2008-09

Source : Drawn with data obtained from RBI (2009 -10)
Since mid-nineties as exhibited in Figure 1, India’s FER – both nominal and real, adjusted for price level – started growing considerably, and reached a new peak in 2006-07 at USD 199179 Million. India’s foreign currency reserves are currently ranked the World’s fourth-largest. Besides, the level of exports increased considerably during late nineties and as a result during 2001-02 to 2003-04, the country’s current account balance was in surplus. Though, in the following period, India’s current account balance turned negative again, the capital account balance was always surplus in the new millennium, which helped the overall balance of payments in remaining emphatically positive.

It is worthwhile to note that during 2007-08 the Rupee had appreciated vis-à-vis the Dollar by more than 10%. This increased the return earned in foreign exchange, when rupee assets were sold and the revenue converted into dollars. The investments turned even more attractive and it triggered an investment spiral. This availability of investible funds in the economy paved the way for outward investment opportunities and the government encouragement to the same should be interpreted in this background.

Thus, the overall picture has been one of secular growth since 1990, interposed by a noticeable acceleration of Reserves buildup since 2002. However, following the collapse of Lehman Brothers in September 2008 and the ensuing global financial crisis, there has been significant amount of capital outflow, resulting in a sharp decline in India’s FER, both real and nominal.

Figure 2 shows the ratio of FER relative to the GDP. The reserves–GDP ratio shows a similar pattern as the absolute amount of reserves; a continual increase, which partly echoes India’s economic growth over time. However, unmistakably, the ratio declines in the aftermath of the recent global financial crisis.

Although the recent global financial crisis started with the busting of housing bubble in US, US financial markets continue to be of crucial importance to the rest of the world: more than $4 trillion of reserves are held in US currency. With global financial crisis, there is a ‘flight to safety’ and investors all over the world are buying US treasury bills even at near zero interest rates. Economists argue that a lack of financial development at home makes foreigners keener to invest in America. What attracts them is the size, liquidity, efficiency and transparency of its financial markets compared with what is on offer in their domestic markets.
Figure 2: Ratio of Foreign Exchange Reserves to GDP

Source: Drawn with data obtained from RBI (2009-10)

In the new millennium, the Reserve Bank of India (RBI) undertook a number of steps for increasing the flow of private outward investments in order to maintain macroeconomic stability, which helped the Indian corporate houses significantly. For instance, the 2003-04 budget of the Government smoothened overseas investment norms for corporate houses by allowing prepayment of External Commercial Borrowings (ECB) of over US$100 million. In the subsequent period, April, 2005, the limit to overseas investment under the automatic route was increased from 100 percent of the net worth of the Indian entity to 200 percent. In June 2007, the limit of overseas investment was further increased to 300 per cent of net worth and further to 400 per cent of net worth in September 2007. Soon thereafter, the RBI further relaxed the overseas investment norms for mutual funds and amended the remittance opportunities through various policies.

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Subsequently, RBI has increased the overseas investment limit for the mutual funds to US$ 5 billion from the earlier level of US$ 4 billion.18 Moreover, the limit on overseas portfolio investment by Indian companies was increased by RBI from 35 percent of their net worth to 50 percent of their net worth in September 2007.19 The Export Import Bank of India also supported more than 200 outward investment ventures by 164 Indian companies in over 50 countries.20

As a result of the reforms undertaken in India, the volume of outward investment flows has increased considerably over the years, as can be observed from Figure 3. It is learnt from the RBI documents that India’s total investments in joint ventures and wholly owned subsidiaries (WOS) abroad reached US$ 23.07 billion (with 2261 proposals) in 2008 as compared to the corresponding figure of US$ 15.06 billion (with 1817 proposals) in 2007.21

Figure 3 : Comparing FDI Inflow and Outflow Figures for India (US $ Million)

(Source : Calculated from the data provided in Singh and Jain (2009)

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Looking at the investment flows in the Indian private sector, it is observed that the investment flows has been directed towards energy sources, metal (e.g. steel, aluminium), pharmaceuticals, IT, banking, industrial products etc., and spanned over various continents. The energy sector has been the maximum receiver of Indian investment, till date. For instance, Essar Exploration & Production (EEPL) has recently bought two offshore petroleum exploration blocks in Australia, and this is first time such initiative being shown by an Indian oil company. In September 2007, Reliance Industries had bought a majority stake of East African oil retailer Gulf Africa Petroleum Corporation (GAPCO), which owned and operated large storage facilities and a retail distribution network in several East African countries. In Latin America, Venezuela’s State-owned oil company PDVSA has recently entered into an agreement with an Indian oil company. Moves to acquire stakes in the retail businesses of BP, Europe’s largest oil company in Malaysia and Singapore have also been considered.

Apart from the private sector, the State supported public sector has also played a key role in ensuring investment in energy sector. The Indian Oil-Oil India combine recently procured three onshore oil blocks in Libya, in addition to the two blocks they already were operating in. Oil and Natural Gas Commission (ONGC) and Videsh Ltd (OVL) have won an oil block in Colombia through auction as part of a consortium. The presence of Indian firms in Africa is also to be noted, as ONGC (24 percent stake) with Malaysian state oil firm Petronas (68 percent stake) enteres into a $400 million agreement

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26 Indian Oil-Oil India win 3 onshore oil blocks in Libya THE ECONOMIC TIMES (December 14, 2007), http://economictimes.indiatimes.com/Oil_Gas/Indian_Oil-Oil_India_win_3_onshore_oil_blocks_in_Libya/articleshow/2623110.cms.
to develop Thar Jath oil fields in Sudan for to an initial capacity of 80,000 barrels per day.\textsuperscript{28}

One interesting feature has been the initial competition between China and India in oil exploration in Africa and Central Asia. China National Petroleum Corportation (CNPC) at one point purchased oilfields in Kazakhstan, Ecuador and Nigeria, which ONGC was also interested in getting into at the time.\textsuperscript{29} However, cooperation between the two sides was noticed subsequently as in December 2005 companies from the two countries successfully bought the Al-Furat oilfields in Syria. Later, the two countries attempted to finalize modalities of future cooperation between OVL and the CNPC, which may pave the way for joint biddings in future.\textsuperscript{30} The presence of SWFs may come beneficial in that scenario.

\subsection*{B. Pros and Cons}

India over the last few years has witnessed a stable macroeconomic regime until the recent global economic downturn and its growth scenario has been comparable only with China over this period. It is observed from the Economic Survey (2007–08) that while the annual GDP growth rate in 2002–03 was 3.8 percent, the same has consistently been over 7 percent for the last five years before the global meltdown. In particular the GDP growth rate during 2005–06 and 2006–07 has been 9.4 and 9.6 percent respectively, the service sector being the largest contributor to this growth. This unprecedented growth scenario has fuelled both gross domestic savings and gross domestic capital formation (investment) significantly. While the gross capital formation expressed as a ratio of GDP has increased from 22.8 percent in 2001–02 to 35.9 percent in 2006–07, gross domestic savings has increased from 23.5 percent of the GDP to 34.8 percent over the same period. The inflation fluctuated over this period, and increased considerably at times, but as a whole

\begin{itemize}
  \item \textsuperscript{28} Sudan inks oil field deal with ONGC consortium Financial Express (March 29, 2005), http://www.financialexpress.com/news/Sudan-inks-oil-field-deal—with-ONGC-consortium/130731/.
  \item \textsuperscript{29} China, India for joint Kazakh oil bid, China Daily (June 11, 2006), http://www.chinadaily.com.cn/china/2006-06/11/content_613810_2.htm.
\end{itemize}
remained within controllable limits. The export growth rate has however suffered to some extent in recent periods, owing to the appreciation of the Indian Rupee vis-à-vis the American dollar. This favourable macroeconomic scenario resulting in the unprecedented level of FER perhaps prompted the Indian Government to think of a hitherto unexplored investment strategy for boosting growth rate further.

In spite of strong macroeconomic fundamentals, India’s balance of payment on its current account has mostly been negative. However, following liberalization in the 1990s (precipitated by a balance of payment crisis), India’s exports increased for some time, covering 80.3 percent of its imports in 2002–03, up from 66.2 percent in 1990–91. However as of 2008-09, the ratio stood at 61.40 percent. At the same time substantial inflows of foreign capital in the form of FPI and FDI explain India’s unprecedented accumulation of FER buildup to the tune of USD 251,985 million in 2008-09. According to economists, there are usually two main motives behind such buildup: the precautionary motive and the mercantilist motive. According to the first explanation, like many Asian economies, following the East Asian currency crisis of 1997–98, Indian Government followed a protectionist approach to safeguard against sudden shortage of international liquidity, by accumulating a large volume of FER. The second explanation says that India’s soaring reserves are an indicator of the country’s overdependence on trade and capital inflows as engines of growth (Park and Estrada, 2009).

Following Park and Estrada (2009) one may use two measures of reserve adequacy to examine whether India has too much reserve buildup and hence ‘surplus’ reserves. One of the measures of India’s susceptibility to currency crisis is the ratio of reserves to short-term external debt. According to the so-called Greenspan-Guidotti rule, the critical value of this ratio is one, with a

31 Calculated from India’s trade data.
32 D. Park, and G. Estrada, Developing Asia’s Sovereign Wealth Funds and Outward Foreign Direct Investment, 26(2) ASIAN DEVELOPMENT REVIEW 57–85 (2009).
33 Id.
34 The rule is named after Pablo Guidotti – Argentine former Deputy Minister of Finance – and Alan Greenspan – former chairman of the Federal Reserve Board of the United States. Guidotti first stated the rule in a G-33 seminar in 1999, while Greenspan widely publicized it in a speech at the World Bank. Guzman Calafell and Padilla del Bosque found that the ratio of reserves to external debt is a relevant predictor of an external crisis, http://en.wikipedia.org/wiki/Guidotti–Greenspan_rule.
value below that signaling danger. The rationale is that countries should have enough reserves to overcome a massive withdrawal of short term foreign capital.

The second indicator of reserve adequacy is the ratio of reserves to M3 or broad money. This ratio is especially relevant for countries like India that are a haven for ‘hot money’ investments by large foreign institutional investors and hence are subject to a major risk of capital flight. The higher the ratio, the greater is the confidence of the general public in the value of the local currency and hence the lower the risk of capital flight from the country. Park and Estrada (2009) suggested a critical value in the range of 5 to 20 percent as a measure of reserve adequacy.

Figure 4 presents a diagrammatic representation of in the time-series value of the two ratios from 1990-91 till 2008-09. Column 2 shows that India comfortably passes the Greenspan-Guidotti test of reserve adequacy as the ratio of reserves to short-term external debt exceeding one in all the years since 1991-92.

**Figure 4: Ratio of reserves to short-term external debt**

Source: Ratios Calculated with data obtained from RBI (2009-10)
Column 3 exhibits that the ratio of reserves to M3 or broad money is above 20 percent for all the years since 2002-03. Thus, a look at both these ratios indicate too much of reserves buildup for the Indian economy particularly since 2002, suggesting thereby that India has substantial amount of surplus reserves.

**Figure 5: Ratio of reserves to M3 or broad money**

Since 2008 the possibility of creation of an Indian SWF has been floated at times, although the same is yet to be constituted. The idea of strategic investment in overseas debt and equity markets has been supported on the ground that it will enable Indian firms in their acquisition drive on one hand and enable higher return on accumulated foreign exchange reserves on the other. The Prime Minister’s Advisory Council on Trade and Industry has recently recommended the creation of a SWF with an initial corpus of $5 billion.\(^{35}\) It has been argued that the creation of such a fund would boost domestic economic growth.\(^{36}\) While the huge volume of FER has prompted

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\(^{35}\) Gaurav Choudhury, *RBI not keen on managing sovereign wealth fund* HINDUSTAN TIME (August 18, 2008).

\(^{36}\) *Finance Ministry May Approve $5 Billion Fund for India SWF* INSTITUTE (February 21, 2008) [http://www.swfinstitute.org/fund/india.php](http://www.swfinstitute.org/fund/india.php).
the Council to come out with such a recommendation, the fiscal deficit (3.4 percent of GDP in 2006-07) and a widening current account deficit (1.58 percent of GDP in 2006-07) has perhaps prompted the Indian Government to move cautiously in this regard.

Because of the democracy in India, the Government would be accountable for the fund’s performance and would face constant pressure of managing dynamic risks involved with a SWF. The transparency and accountability that go with a democracy are not a convincing argument against having a SWF. Many democracies have very successful, accountable, and transparent SWFs including Norway, Australia, Canada, and the United States (Alaska).

The increasing inclination of India towards SWFs in the recent period is becoming evident through the perspectives of policymakers in different forums. Carl Linaburg, Co-Founder and Vice President of the Sovereign Wealth Fund Institute, noted that the Governor of the RBI has recently mentioned during a speech in Washington that India is indeed interested in creating a variant of SWF in the coming future. It is expected that the SWF would function as a reserve investment corporation, and try to earn higher returns through diversifying into equity investments rather than lower risk investments such as treasury bonds.

However, the justification of India’s recent inclination towards SWFs has been questioned by a section of professionals and economists. One major cost of reserve accumulation is that it is inflationary. When the RBI issues domestic currency to purchase foreign currency, it increases the monetary base, which in turn leads to inflation. Although the RBI uses a sterilization mechanism to neutralize such inflationary effect and through open market sale of bonds, it puts pressure on interest rate and hence on Government’s fiscal prudence.

It is argued that India’s achievements in sectors such as infrastructure, education basic health care are still innocuous as compared to China and

37 India not in a good position to start SWF Excess Liquidity (February 12, 2008), http://sovereignwealthfunds.wordpress.com/category/sovereign-wealth-funds/.
other economies currently having SWFs. Moreover, the country possesses a limited natural resource endowment and the current account deficit is quite high. In these circumstances, returns on well-picked domestic investments should match the same earned by corresponding SWF returns. It is also argued that the SWFs take time to mature in terms of investment decisions, and that in the learning stage they are susceptible to mistakes just like the financial companies.

India has however made its choice clear in recent period, when it decided to create room for investing the FER in infrastructure projects abroad. For this purpose, India Infrastructure Finance Company Limited has been set up as a wholly owned subsidiary in London in 2008. The subsidiary will borrow up to US $ 5 billion from RBI by issuing US-dollar denominated bonds and will lend the resources to Indian infrastructure companies for meeting their capital expenditures outside India (Economic Survey, 2009-10).

Another major criticism against the possible establishment of a SWF by India highlights the potential volatility of the FER and the global capital markets, especially in the face of the economic downturn. The investments in the global market in general are risky, and a consequence even the SWF investments would be such. Moreover, the idea of floating SWFs has been guided by massive FER in recent years. While the average annual FER growth rate was 9.66 percent over 1995–96 to 2000–01, the same has increased to 30.15 percent from 2001–02 to 2006–07. Over 2001–02 to 2006–07, the FER has increased by more than 145 billion. Now if the global economic downturn continues and the FER stock depletes, the future of the SWF venture may not be very bright.

The Asian Development Bank in 2008 noted that in the traditional SWFs, countries like Norway and the Gulf states have mostly invested their oil export revenues through the fund. On the other hand, the newly created SWFs in Asia (e.g. – China and Singapore) are mostly relying on conventional current account surpluses derived from non-resource exports for investment. Given

39 Should India Set up a Sovereign Wealth Fund? It's a Bad Idea INDIA KNOWLEDGE@WHARTON (March 27, 2008), http://knowledge.wharton.upenn.edu/india/article.cfm?articleid=4272.

the fact that India’s current account balance has worsened in the last couple of years, it could be noted that Indian SWF would not belong to either group. On the other hand, the increase in India’s FER has been caused by speculative capital inflows on the capital account. Hence, it is argued that the amount needs to be considered as ‘liabilities’ created by sound domestic macro conditions and the global liquidity boom but not as ‘sovereign wealth’. In other words, the reserve is very much exposed to potential sudden outflows by foreign investors and any decision should be taken keeping this perspective into account.41

Apart from the economic criticisms, the possibility of the existence of SWF should also be understood in terms of the political scenario in India. The experience of Capital Account Convertibility (CAC) should be taken as a parallel here. The Tarapore Committee report on CAC in 1997 recommended introduction of CAC in India. However, the Southeast Asian crisis delayed the same. Even a decade after the debate on introduction of CAC was initiated by the Prime Minister of India the required policy change was not witnessed.42

It is to be noted that the previously elected coalition Government was then receiving support from conservative Left parties. After completion of the general election in 2009, the new government was not dependent on the Left parties for support, and was in a better position to negotiate new financial policies. Hence, the idea of creating an Indian SWF may eventually materialize in coming days.

C. Possible characteristics of the Indian SWF

Given the fact that the policymakers have expressed their willingness to realize an Indian SWF in recent years, three issues needs to be taken into account to understand the coverage and depth of a potential SWF in the future. The first issue would be the potential size of such an SWF; second, the investment strategies to be adopted by the SWF; and finally, the management pattern of the newly created SWF.

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The first and foremost question in this subject is to determine the size of the proposed Indian SWF. It is revealed from the reactions of the policymakers at various points of time that the Government is considering creation of a SWF with an initial corpus of US $ 5 billion. However any final decision on that front is yet to be arrived at.43 Given the fact that currently India’s FER is about to touch 200 billion, the figure may look meagre in that comparison in isolation. However, it needs to be borne in mind that barely a decade back, India’s FER was around US $ 26 billion and in 2002-03, the same was around 75 billion. The spectacular growth in the FER has been witnessed only in the recent period fuelled by capital inflow. In that perspective, India should perhaps start with a modest initial SWF operation of US $ 5 billion and contemplate over the optimal size of it’s SWF a few years after the same is operational, based on practical experience (i.e., risk uncertainty and the size of returns).

It is generally argued that SWFs intend to manage non-commodity based assets to increase returns on reserves. However, their investment decisions should be based on commercial considerations and not on geo-strategic reasons. Looking at India’s current outward investment trends, it could be ascertained that its SWF investment strategies might keep two considerations in mind: one, increased returns on reserves and two, ensuring energy security. Given the oil price trends in recent times, perhaps the two may not be completely uncorrelated from an Indian perspective. Hence, a proportion of the newly created SWF may definitely be utilized in India’s energy security quest. The other target areas might include iron and steel sector and other fields where the possibility of return looks higher.

The management of SWF in the turbulent era of global slowdown has received wider focus in recent period. Linaburg has however argued that India is not a new player as far as SWF type operation is concerned.44 The country has earlier created the India Infrastructure Finance Company Limited (IIFC) in 2004, which provides long-term debt for financing public private

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44 Supra note 38.
partnership infrastructure development projects in India. The IIFC has the experience of raising money through equity finance, currency debt raised on the open market, debt from multilateral and bilateral institutions, foreign currency debt through external commercial borrowings etc. All these experiences makes IIFC an ideal body for managing the Indian SWF, once the same is established.

It is to be noted that the RBI has welcomed the idea of setting up of a SWF but is not keen to manage it. The argument is that the existing RBI mandate to perform as a Central Bank might refrain it from successfully managing the SWF type operation. It has recently suggested to the Parliamentary Standing Committee on Finance that a dedicated and independent entity set up by an act of Parliament instead would be the best forum to do so.\(^4\)

Given these circumstances, perhaps the best way of managing an Indian SWF would be to follow the RBI recommendation, and the independent entity created for this purpose should be benefited from the experience of both the IIFC and RBI. There should be executives from both these bodies present in the managerial board of the Indian SWF. The newly created entity should also have representatives from the Ministry of Finance and industry associations.

II. The Regulatory Obstacles an Indian SWF Would Face

There are few, if any, examples of SWFs that have caused damage to MNEs or the international financial system. Nevertheless, the newly established SWFs such as CIC from China have led to considerable concern among experts in international economics and finance. These concerns are mostly based on a fear of political interference by the Chinese Government in economic exchange and business activities rather than actual incidence of it.

The prime goal for China in establishing an SWF seems to be to make profitable use of the foreign exchange it has accumulated as the result of

\(^4\) Supra note 35.
trade imbalances or foreign exchange intervention. Yet, other reasons may also play an important role. Essentially, China is saving today to consume even more in the future when China will be richer. This poses a puzzling behaviour. China is, after all, a relatively poor but rapidly growing country, and would possibly be better off with a higher consumption rate today. The ultimate outcome is that the Chinese government exchanges its own bonds for foreign assets. But this mechanical explanation fails to answer the question why China accumulates foreign assets, rather than consuming more or even investing more in domestic physical assets? It follows from such argumentation that the activities of the Chinese SWF must be assumed to also be being used for other, strategic goals: Chinese economists have argued that the available savings could support the economic development of China best if used to as means to acquire international technologies, brands, and resources, and to smoothen access to international markets.46

From a macro-economic perspective, major shifts in SWF investments could potentially disrupt global financial markets. On a national level, politically driven investments in a country could raise national security concerns. Furthermore, there is a possibility that China could use the CIC as a mechanism to pursue geopolitical objectives. For example, a strategic investment in natural resources with means that exceed those of Western MNEs could be a step towards controlling resources in times of future shortages. Yet, one may doubt the neutrality of State actors in a landscape dominated by private business.

The controversy over SWFs is essentially about the interaction of two very different concepts of the role of government in a capitalist economy, state capitalism as opposed to market capitalism. Where elements of state capitalism interfere in a tradition of market capitalism, a potential for abuse or corruption may arguably be created by the greater proximity an SWF creates between governments and the private sector. Particularly with regard to banks and the financial sector, in which the CIC has already strongly invested, a growing network of interlinked investments between banks and

other financial firms within China and overseas can be assumed. In practice, CIC’s investment in companies such as Morgan Stanley may provide them with unfair preferential access to China’s domestic financial markets, or, in return, overseas financial firms may be put under pressure to treat Chinese companies in global business preferentially compared to others. Neutrality of the business sector and a level playing field for MNEs worldwide is at stake.

The BRIC (Brazil, Russia, India and China) countries are currently witnessing 14 percent of global SWF inward investments. For instance, among the major global investors, Temasek is currently holding stakes in ICICI Bank in India. Also the Norwegian Pension Fund, the world’s third largest sovereign welfare fund, is keen to invest $2 billion in Indian bonds and equities. The inflow has been caused by the absence of strong control over foreign SWF movements. India currently does not restrict the inflow of the SWF investments in any discriminatory manner vis-à-vis any comparable investment made by other agencies. The Ministry of Finance has noted in 2008 that foreign SWFs do not pose any threat to India’s economic interests.

However, the decisions to allow firms in India may sometimes be influenced by the SWF-related provisions elsewhere. For instance, Reiche (2008) has noted that the operation of the British Metal and mining firm Vedanta Resources Ltd. and its subsidiaries Sterlite Industries Ltd. and Madras Aluminum Company Ltd. have been banned in India because of their environmental and human right violation records. Interestingly however the ban was introduced after Vedanta’s exclusion from the Norwegian SWF.

In response to the global stream of events, the United States maintain the option of screening investments made on their territory. The considerable

47 Ming Zhang and Fan He,17(1) China’s Sovereign Wealth Fund: Weakness and Challenges CHINA AND WORLD ECONOMY 101-116 (2009).
flows of international investments occurring in Europe reflect their freer policy regime regarding movement of capital. Because of the concerns existing in Europe, the European institutions decided in 2008 to agree on the basic principles that should shape the EU approach towards SWFs. A consensus emerged towards a common approach. It has been decided not to create ex nihilo a new mechanism of control but to rely on the existing rules of the common market that enable Member States to derogate to the principle of freedom of movement of capital. The next part of the paper focuses on the regulatory mechanisms in the US and the EU.

**A. The regulation of SWF in the United States**

Though the earlier Bush Administration had been generally supportive of SWF investments, concerns were expressed at times. For instance, Christopher Cox, Chairman of the U.S. Securities and Exchange Commission (SEC), raised concerns on the following issues:

- At times, foreign governments may not be fully cooperative with insider-trading investigations.
- On certain occasions, SWFs may be the beneficiaries of economic intelligence from national security services.

The US approach since 2007 has been summarized by the former Secretary of Treasury Paulson: Who said that “money is naturally going to gravitate toward dollar-based assets because of the strength of our economy,” … Paulson further noted, however, that “I’d like nothing more than to get more of that money. But I understand that there’s a natural fear that they’re going to buy up America.”

In the US, a specific mechanism ensures the control of SWF investments in the national economy. Indeed, since 1988, the United States has had a legal framework to forbid a foreign investment if it threatens to impair US national

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security. The Committee on Foreign Investment in the United States (CFIUS), an inter-agency committee chaired by the Secretary of US Treasury, takes part in the US investment policy analysis through reviews that protect national security while maintaining the credibility of open investment policy.

As a committee of the US executive branch, the CFIUS takes responsibility for monitoring overseas acquisitions of 10% or more of a domestic company’s total ownership. Critics argue that the 10% ownership threshold for reviewing these investments is inadequate, pointing out that investors who acquire smaller ownership shares can have a dramatic impact on a company, and on an economy at large. Interestingly no definition of national security exists in CFIUS.

Filing a notice with CFIUS of a foreign acquisition is voluntary and typically done at the initiative of the parties. However, parties are motivated to file by the fact that the law empowers CFIUS and the President to dissolve the acquisition at any time in the future, even after an acquisition has been completed, if a filing was not made.

After a transaction has been filed, CFIUS conducts an initial review, utilizing the full intelligence and national security infrastructure of the US government, based on detailed information from the parties, which frequently receive questions and requests for clarification from CFIUS. The scope of these reviews focus on two key thresholds:

⇒ **Test 1:** Is there credible evidence that the foreign interest exercising control might take action that threatens national security?

⇒ **Test 2:** If yes, do laws other than the Exon-Florio and the International Emergency Economic Powers Act provide adequate and appropriate authority for the President to protect national security?

If consensus exists that no credible threat to national security exists, or threat has been mitigated, CFIUS decides, within 30 days, not to open a further investigation. If threats exist, or agencies are divided in their opinion, CFIUS conducts an investigation for an additional 45 days, after which CFIUS is required to file a report with the President. The President will have 15 days to make a decision whether or not to block a transaction.
It is always possible to negotiate during both initial and further reviews. It is observed that in the past, certain parties have dropped out of transactions when CFIUS’s national security concerns have been insurmountable, made commitments regarding the composition of the Board of Directors (adding American citizens or guaranteeing that a Board will only be composed of Americans), or even committed to maintain research and development in the US. In other words, CFIUS can leverage the approval process to win concessions that further improve and guarantee US national security.

Since 1988, foreign companies have sent CFIUS several thousand notifications of intent to purchase US companies, but CFIUS has only investigated a few, and of these, it has blocked only one. That case involved the purchase by the China Aviation Technology Import-Export Corporation (the import-export arm of Beijing’s Ministry of Aerospace), of MAMCO, a privately-owned, Seattle-based manufacturer of civilian aircraft parts. CFIUS’s actual impact however may be greater, since many firms withdraw their offers if it looks like CFIUS may investigate them.

B. The regulation of SWF in the European Union

It is often argued that an EU committee on foreign investments is required to mirror arrangements in the US, for an EU-wide screening mechanism or some “golden shares” mechanism for non-EU foreign investment. Such a mechanism is not anticipated at the European level. The internal debate experienced on this area within the EU had different aims from those of the US. There is a clear consensus of EU institutions towards a common approach. The European Commission took the initiative in a communication released in February 2008, which was supported by the European Council and the European Parliament later in the year.

52 These are non-standard shares, the ownership of which confers special rights on the holder. Recent landmark decisions of the ECJ regarding compatibility of “golden shares” with EC law are a clear indication that the concept of “golden shares” violates one of the four fundamental freedoms conferred on individuals by the EU Treaty, namely the free movement of capital. According to case law of the ECJ rules governing “golden shares”, an actual exercise of any rights attached to a “golden share” by any public body must be based on criteria of non-discrimination and an effective legal remedy has to be guaranteed. The judgments do not present a straightforward prohibition of “golden shares”, however, they set out strong limits on their application. See European Court of Justice, Commission v Netherlands, C-282/04 (September 28, 2006).
In February 2008, the Commission presented a communication entitled ‘A common European approach to Sovereign Wealth Funds’. In common with all the Commission Communications documents, this text is one with no legal significance sent by the Commission to the other European institutions. The aim of the Commission is to set out new programmes and policies. According to this 2008 communication, new legislative measures at Community level are unnecessary. The common approach recommended by the Commission was based on five principles:

- commitment to an open investment environment,
- support of multilateral work,
- use of existing instruments,
- respect of EC Treaty obligations and international commitments,
- and finally, proportionality and transparency.

The Commission is thus seeking to avoid legislative action and envisages soft measures, such as guidelines, accompanied by efforts at the international level to increase transparency of SWFs. It is important to note that the Commission’s communication is recommending the common European approach as a complement to the prerogatives of Member States regarding the use of their national legislation.

The Council took over the ideas set out by the Commission, clarifying, in particular, two principles out of the initial five, along the following lines.

- On the one hand, rather than expressing its support for the multilateral approach in general, it preferred to express its position specifically on the work under way in the IMF and the OECD.

- On the other hand, rather than referring to the use of the existing instruments, and once again taking a more general approach, the Council thought it more appropriate to adopt as a basic principle the use of national instruments and EU instruments, if necessary.

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Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, A common European approach to Sovereign Wealth Funds, COM/2008/0115 final (February 27, 2008).
The European Council supported the objective of agreeing at the international level on a voluntary Code of Conduct for SWFs and defining principles for recipient countries at the international level. In this respect, they reiterated the EU's “support for the ongoing work in the International Monetary Fund (IMF) and the OECD”. In any event, this is a clear rejection of a European wide screening mechanism that would echo the system in the United States.

The most important measure with respect to potential obstacles to SWFs’ investment in the EU is Article 58 EC. It stipulates that the Member States have the right to put in place restrictions on grounds of public order or public security. A Member State is entitled to restrict Treaty freedoms on the basis of legitimate national security concerns. Free movement of capital, unlike the other freedoms of movement established by the EC Treaty, does not apply solely between Member States. It also prohibits restrictions on the movement of capital between Member States and third countries. This is true in respect of all investments, be they from SWFs, State-controlled companies, private companies or others. Furthermore a number of Member States have measures in place that, for example, restrict investments in the defence sector.

It needs to be emphasized here that the list of justification measures in Article 58(1)(b) EC is not exhaustive. However, whatever the ground relied on, the measure in question must be suitable for the purposes of attaining the objective which it pursues and not go beyond what is necessary in order to attain it: proportionality test. The Court has also provided criteria to assess the proportionality: national measures must aim at the protection of a legitimate general interest and foresee strict time limits for the exercise of opposition powers; assets or management decisions targeted must be specifically listed.

Article 58 has never been invoked in the context of SWFs. In other words, no Member state has ever adopted a law restricting FDI from SWFs nor has a Member State ever enforced a decision rejecting a SWF investment arguing as to the validity of the decision as an exception (Art. 58) to the principal of freedom of capital movement (Art. 57).

Recent experience shows that the opacity of some SWFs risks prompting defensive reactions. In October 2008, the Italian government announced first
that SWFs wanting to buy shares in Italian companies should ‘generally’ stay below 5 per cent, suggesting that a new law should be passed. This was a reaction to the purchase by Italy’s former colony, Libya, of a 4.23 per cent stake in the number two Italian bank UniCredit SpA.54 However, shortly after this, Foreign Minister Franco Frattini said that while there was no need for a threshold there was a need for transparency.55 Such a reversal should be interpreted as an abandonment of any plans to pass a new law. On the other hand, it possibly refers to the multilateral approach supported by the EU.

However the UK and France have already introduced legislation allowing them to fend off investments from SWFs. Germany passed a new law that came into force in April 2009. The Cabinet of the German Ministry for the Economy took a decision on Foreign Trade and Investment Law on 20 August 2008.56 This decision is aimed at protecting strategic German industries from unwanted foreign takeovers. Since April 2009, the law gives the German federal government the right to veto any investment from non-EU or European Free Trade Association countries (i.e. Switzerland, Norway, Liechtenstein and Iceland) amounting to 25% or more of a company’s stakes, if it deems that “public security” or “public order” is at risk.57

There is a risk of witnessing a different strategy being implemented in each of the Member States rather than a unique policy at the EU level, which, ultimately, would not help tackle reality. There is a need to make clear at the European level the sectors that ought to be protected from foreign takeovers and an attempt should be made to go beyond the existing vague criteria of public order and public security.

54 G. Dinmore, Italy set to curb sovereign wealth funds FINANCIAL TIMES (October 21, 2008).
55 No need to cap sovereign fund holdings REUTERS AGENCY (October 23, 2008).
57 Thirteenth Act amending the Foreign Trade and Payments Act and the Foreign Trade and Payments Regulation (April 18, 2009). Based on the US model, Germany’s plans could lead to further attempts across the 27-Member EU aimed at blocking foreign investment incursions into sensitive industries. US inspiration is obvious as foreign investors can now pre-notify the German administration, on a voluntary basis, before an intended acquisition to obtain legal certainty. Under Germany’s proposals, “public order and security” are the principal criteria for triggering a review of foreign groups’ investment plans.
Such a list of EU strategic sectors should be drafted, which may isolate energy, technologies and other relevant sectors from SWF entry. In addition, public mistrust of overseas investment and isolationist sentiment could cause an overreaction to the question of regulation. This could have far-reaching consequences not only financially, but also in terms of diplomatic and economic relationships with other nations. For instance, European leaders do not have the same policy towards Russia as they do towards the US.

As a result, there is a need to clarify the interpretation of Article 58 ECT, which provides for restrictions on the free movement of capital on grounds of public order. Because it has not been applied until now in the context of SWFs, it is worthwhile ensuring that Member States will not be tempted to make extensive use of it.

C. Multilateral rules: obstacles or opportunities?

In October 2007, the G7 Finance Ministers invited major multilateral organisations, such as the IMF and the OECD, to launch a reflection on the role of SWFs and on the mechanisms to address the challenges they pose. Since the G7 summit, the activities in the IMF and OECD have been running in parallel but do not deal with exactly the same themes. They are however generally described as complementary.

OECD has finished its work in 2009, and the playing field has not been changed. The IMF agreed on a set of 24 voluntary principles for the funds to follow and to ensure their competitiveness in global financial markets. These Generally Accepted Principles and Practices (GAPP) or “Santiago Principles” were released on 11 October 2008 and appeared in Annex 1. A bit earlier, the pioneering work of Edwin Truman, which provides a basis for evaluating the results of the IMF-sponsored dialogue, chalked out a blueprint for SWF best practices.58

The drive by the US and the EU to draw up the code of best practices, including a renunciation of political motives, has stirred resentment among

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58 Edwin Truman, A blueprint for SWF best practices, Number PB08-3 Peterson Institute for Economics, (April 21, 2008).
some of the investors responsible for the funds, particularly in China and some Gulf States. The challenge for IMF in delivering this difficult task was known from the beginning, but it became even more complex in the context of the financial crisis.

The IMF principles encourage the funds to explain their investment criteria, and recommend that they avoid buying stakes in sensitive companies, such as Western defence contractors. They also vote on setting up a Standing Committee that will update the guidelines and liaise with Western governments and institutions such as the World Bank and IMF on issues of concern.

The principles make repeated mention of the need for greater transparency. The full list of principles includes recommendations that SWFs coordinate their activities with their respective governments and central banks to avoid interfering with domestic economic policy. The members have committed that funds should disclose their sources of funding and the conditions under which their owners can withdraw them. They have committed to make disclosures as applicable under local laws and regulations. Of key significance in this regard are Principles 11, 12, and 22. Further, sovereign fund managers should be independent of the fund owners, but fully accountable, publishing annual reports and undergoing annual audits.

To address the criticism among some economists that the funds’ secrecy contributes to volatility in capital markets, the principles call for funds to disclose “relevant financial information” to “contribute to stability in international financial markets and enhance trust in recipient countries.” Each funds’ investment policies should be made public, including the extent to which they employ outside managers. The principles also address concerns about conflicts of interest arising between the funds and their government owners, calling for funds to avoid taking advantage of privileged information or influence when investing.

But the principles stop short of requiring an explicit pledge not to invest for political ends. The principles include a call for funds to abide by local rules and regulations and base their investments on financial and economic grounds. They even call on funds to disclose any investment decisions “subject to other than economic and financial considerations.”
Above all the IMF guidelines are based on a standard definition of SWFs. They do not cover SOEs as made clear by a footnote. Consequently they could find themselves in the pointless situation of being rigorously adhered to, for e.g. by Norway’s Government Pension Fund – Global, while Russia’s Gazprom felt no need to take any notice of them. If so, the SWF guidelines will serve little more than a public relations purpose if they encourage sovereign investment to flow through other investment vehicles not covered by the guidelines.

It might then make sense to go on to redefine SWFs along broader lines. Robert Kimmit, the current Deputy Secretary of the Department of the US Treasury, suggests that SWFs could be conceived as “large pools of capital controlled by a government and invested in private markets abroad”,\(^{59}\) rather than as the funds that serve exclusively as investment vehicles for these pools. With “sovereign wealth fund” defined in this way, a code of conduct for SWFs would cover sovereign wealth at its source, regardless of the route it then took to reach any foreign investment target.

Edwin Truman made a preliminary assessment of the GAPP using the 33 elements in the “2008 Blueprint for SWF Best Practices”. The GAPP receives a satisfactory “score” of 74. The GAPP rank within the top group of 22 pension and nonpension SWFs out of 46 such funds. It means that should each SWF comply completely with the GAPP, they would all move into that top group. As emphasized by Truman, “the fact that the GAPP does not score 100 on my rating system reflects reality. It is a compromise, a negotiated document”.\(^{60}\) The weakest area is with respect to accountability and transparency. Disturbingly, many of the principles are silent about disclosure to the general public or only call for disclosure to the fund’s owner. That approach does not promote the needed accountability to citizens of the country with the SWF or of other countries.

It seems then that it would be in the interest of governments to make use of the multilateral code of Santiago principles, rather than being subjected to the EU or the US mechanisms. A robust implementation of the ‘Santiago principles’ should go far towards resolving questions about the transparency,

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accountability, and operations of SWFs. The issue for the IWG is “voluntary” compliance with the GAPP. However, some signals are encouraging, since Abu Dhabi Investment Authority (ADIA) had expressed support for the Santiago Principles. Additionally, “to underline its commitment to full compliance, ADIA has established an inter-departmental committee to oversee compliance with the GAPP. Furthermore, ADIA is analyzing the feasibility of establishing a mechanism that would provide independent verification of its compliance with the GAPP”. 61

What can be seen at first sight as a burden could be turned into an advantage. Indeed complying with the Santiago Principles will mean accepting the multilateral rules accepted by all. Any SWF which would comply with such rules could expect a good treatment from both US and European authorities, and will not be subject to the uncertainties resulting from their procedures.

III. Conclusions

As the current financial turmoil demonstrates, financial liquidity is vital for Western economies. Recently firms on both sides of the Atlantic – for example Barclays and Citibank, seek out sovereign funds. Their finance was needed to allow these companies to fulfil their strategic aims. Even Russian sovereign funds have not attempted to buy into any strategic assets; they are taking very limited stakes in some companies and the European Commission and the national governments are watching this activity. But there is no evidence at the moment that these sovereign funds are being used for any nefarious purpose.

This paper does not explore all the potential rules applicable to SWF. For instance, it is questionable whether WTO law (and GATS through its mode 3 in particular) gives rights to SWFs and limit the scope of control governments have the right to exert.62 There is a strong presumption for this but this complex issue calls for further research.

61 Available at http://www.adia.ae/ADIA_AE_press.asp.
SWFs constitute an important element in the policy dimension of many countries that decided to set up such a fund. For instance in China, they are a key example of the interference of the Chinese government in business transactions and the private sector, which may not be present in the Indian case. However, as the earlier analysis suggests, there may exist a commonality of interest between the public and the private sector in India in terms of outward investment (e.g. – energy). In addition, it is to be noted that acquisition attempts in strategic sectors like steel by Indian private players have already been criticised in Europe (e.g. – Arcelor-Mittal takeover in 2006) and any SWF operation in that area might also be viewed in that light.

The objective of this paper has been to depict the existing regulatory framework applicable to SWF investment in order to identify the main regulatory challenges an Indian SWF might face abroad. IMF principle 24 says that “A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF”. It is seems to us that there is a necessity to respect all the Santiago principles when setting up Indian SWF so as to take advantage of these minimal standards. Respecting each Santiago Principles will put Indian SWF in the category of “good SWF” and then limit regulatory obstacles it could face in the US market or the multiplicity of regulations in the EU market. Interestingly, the use of mere guidelines as opposed to hard regulation may in fine mark a milestone in rationalizing the integration of SWFs into the global capital markets.

Complying officially with IMF guidelines should not require a lot of concessions from the Indian side. Since the Santiago principles remain quite vague and minimal, a good strategy would be to respect them and use these standards as a tool to ensure that Western countries will not create obstacles that run against the philosophy of this core of multilateral principles.
ANNEX 1: A SUMMARY OF THE 24 GENERALLY ACCEPTED PRINCIPLES AND PRACTICES (GAPP)

• **GAPP 1. Principle**

  The legal framework for the SWF should be sound and support its effective operation and the achievement of its stated objective(s).

  - **GAPP 1.1 Subprinciple** The legal framework for the SWF should ensure the legal soundness of the SWF and its transactions.

  - **GAPP 1.2 Subprinciple** The key features of the SWF’s legal basis and structure, as well as the legal relationship between the SWF and the other state bodies, should be publicly disclosed.

• **GAPP 2. Principle**

  The policy purpose of the SWF should be clearly defined and publicly disclosed.

• **GAPP 3. Principle**

  Where the SWF’s activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.

• **GAPP 4. Principle**

  There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF’s general approach to funding, withdrawal, and spending operations.

  - **GAPP 4.1 Subprinciple** The source of SWF funding should be publicly disclosed.

  - **GAPP 4.2 Subprinciple** The general approach to withdrawals from the SWF and spending on behalf of the government should be publicly disclosed.

• **GAPP 5. Principle**

  The relevant statistical data pertaining to the SWF should be reported on
a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.

• **GAPP 6. Principle**

The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.

• **GAPP 7. Principle**

The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF’s operations.

• **GAPP 8. Principle**

The governing body(ies) should act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions.

• **GAPP 9. Principle**

The operational management of the SWF should implement the SWF’s strategies in an independent manner and in accordance with clearly defined responsibilities.

• **GAPP 10. Principle**

The accountability framework for the SWF’s operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.

• **GAPP 11. Principle**

An annual report and accompanying financial statements on the SWF’s operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.
• **GAPP 12. Principle**

The SWF’s operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a consistent manner.

• **GAPP 13. Principle**

Professional and ethical standards should be clearly defined and made known to the members of the SWF’s governing body(ies), management, and staff.

• **GAPP 14. Principle**

Dealing with third parties for the purpose of the SWF’s operational management should be based on economic and financial grounds, and follow clear rules and procedures.

• **GAPP 15. Principle**

SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.

• **GAPP 16. Principle**

The governance framework and objectives, as well as the manner in which the SWF’s management is operationally independent from the owner, should be publicly disclosed.

• **GAPP 17. Principle**

Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

• **GAPP 18. Principle**

The SWF’s investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the
owner or the governing body(ies), and be based on sound portfolio management principles.

- **GAPP 18.1 Subprinciple** The investment policy should guide the SWF’s financial risk exposures and the possible use of leverage.

- **GAPP 18.2 Subprinciple** The investment policy should address the extent to which internal and/or external investment managers are used, the range of their activities and authority, and the process by which they are selected and their performance monitored.

- **GAPP 18.3 Subprinciple** A description of the investment policy of the SWF should be publicly disclosed.

**GAPP 19. Principle**

The SWF’s investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.

- **GAPP 19.1 Subprinciple** If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.

- **GAPP 19.2 Subprinciple** The management of an SWF’s assets should be consistent with what is generally accepted as sound asset management principles.

**GAPP 20. Principle**

The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.

**GAPP 21. Principle**

SWFs view shareholder ownership rights as a fundamental element of their equity investments’ value. If an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The
SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.

- **GAPP 22. Principle**
  
The SWF should have a framework that identifies, assesses, and manages the risks of its operations.

  - **GAPP 22.1 Subprinciple** The risk management framework should include reliable information and timely reporting systems, which should enable the adequate monitoring and management of relevant risks within acceptable parameters and levels, control and incentive mechanisms, codes of conduct, business continuity planning, and an independent audit function.

  - **GAPP 22.2 Subprinciple** The general approach to the SWF’s risk management framework should be publicly disclosed.

- **GAPP 23. Principle**
  
The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.

- **GAPP 24. Principle**
  
A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.
Precedents in Investor State Arbitration

Akshay Kolse-Patil

ABSTRACT

While admittedly there is no rule of stare decisis (binding precedent) in international law or investor state arbitration, increasing number of tribunals refer to “precedents”. This trend has led many to ask if there is a system of binding precedent in investor state arbitration. This paper seeks to answer this question with a qualified affirmation – though there is no strict rule of binding precedent in international investment law, previous decisions do have a limited but powerful precedential value. While previous decisions are not binding, they provide guidance and may influence future tribunals in their decision making. The current regime has some of the characteristics (like timely publication of awards, similarity of applicable law, similar facts and authoritative tribunals) of a common law system required to establish precedents. However, this passing similarity is not sufficient to establish a binding rule of precedent due to the lack of formal power and ad hoc nature of the tribunals, the difference in the wording of investment treaties and the likelihood of inconsistent decisions. Therefore, tribunals use prior decisions as aids to justify their reasoning and not as straightjackets to bind their reasoning.

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1 Advocate, Bombay High Court.
I. INTRODUCTION

Some would say that consistency requires you to be as ignorant today, as you were a year ago. However, in the field of international investment law, and the law in general, consistency may be more a sign of enlightenment than ignorance. Consistent application of precedents provides fairness and equality as like cases are dealt with in a like manner. This paper will look at recent decisions in investor state disputes that have at once sought to establish consistency, through the use of precedents, in contradistinction to those that have through divergent and diametrically opposite decisions added an element of inconsistency. This paper through analysis of the emerging case law seeks to establish that while currently there is no strict rule of binding precedent in international investment law, previous decisions do have a limited but powerful precedential value. Though previous decisions are not binding, they do provide guidance and may influence future tribunals in their decision making.

One of the principal aims of investment treaties has been to provide a stable climate for investments – investment climate matters for the level of productivity, wages, and profit rates, and for the growth rates of output, employment, and capital stock at the firm level. In contrast inconsistent

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4 The preamble of the US model BIT reads as follows: “The Government of the United States of America and the Government of [Country] (hereinafter the “Parties”)… Agreeing that a stable framework for investment will maximize effective utilization of economic resources and improve living standards.”
decisions threaten to frustrate the purpose of investment treaties – providing states and investors with a stable climate and confidence regarding their respective rights and obligations.\textsuperscript{6} Consistency in decisions, which can be obtained through precedents, would definitely assist in providing stability. The need for consistency and stability is further accentuated with the current rise in flows of capital across borders. According to UNCTAD, global FDI flows totaled at $1.979 trillion in 2007.\textsuperscript{8} Flows to developing countries increased by 17\% over 2008 to a total of $621 billion.\textsuperscript{9} There has also been a startling growth in the number of BITS. In 2008 alone, 59 new BITS were concluded, bringing the grand total to 2,676.\textsuperscript{10} At the same time there has been a dramatic rise in trade agreements with provisions relating to investment. There were 273 such agreements by the end of 2008.\textsuperscript{11}

As a consequence of the rise in FDI flows and in the number of investment related agreements, as well as their increasing sophistication and breadth of coverage, it is hardly surprising that there has been a growth in the number of investment related disputes. International Centre for Settlement of Investment Disputes (ICSID) has decided a total of 189 disputes and a further 127 disputes are pending.\textsuperscript{12} Many investment disputes are conducted under ad hoc tribunals under different rules, such as UNCITRAL rules, and are not publicized. Therefore the true number of disputes is larger. Further given that the specter of bankruptcy is haunting several countries in Europe, and also may be elsewhere, there is a genuine possibility that may be a slew of new disputes. This imminent threat of new disputes requires an urgent study of the concept of precedents in investor state arbitration.

\textsuperscript{5} D. Dollar, M. Hallward-Driemeier, and T. Mengistae Investment climate and firm performance in developing economies, 54 ECON. DEV. & CULTURAL CHANGE 1, 27 (2005).
\textsuperscript{8} Investment flows have reduced currently because of the ongoing financial crisis, but are expected to recover by 2011 as per the UNCTAD (New York and Geneva, 2009) - World Investment Report 2009 xix (2009).
\textsuperscript{9} See World Investment Report 2009 (Overview), supra note 7.
\textsuperscript{10} Supra note 8, at 12.
\textsuperscript{11} Supra note 8, at 12.
\textsuperscript{12} See List of ICSID Cases (June 4, 2010) http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ShowHome&pageName=Cases_Home.
This paper seeks to understand the value, and the role, of precedents in international investment. The paper shall proceed as follows: the second part of the paper will explain the concept of precedent, as it exists in different legal systems. Part three will then look at limitations on the development of precedent in international investment law. Part four will discuss some of the systemic requirements that would be needed to be satisfied by the current investor state arbitration regime to establish precedents. Part five will then analyze recent case law to see if there actually exists a system of precedent in international investment arbitrations. And Part six will conclude.

II. WHAT ARE PRECEDENTS?

A. Common Law

The common law doctrine of *stare decisis* or binding precedent was born from Bracton’s first collection of English decisions. Bracton’s *Note Book* containing the first collection of English decisions gave early impetus to the doctrine. The doctrine, *stare decisis et non quietamovere* – to abide by the precedents and not disturb settled points, embodies the policy of the courts, and the principal, upon which rests the authority of judicial decisions as precedents in subsequent litigations. The concept is applied by common law courts so that once a principle of law has been laid down applying to a certain set of facts, they will adhere to that principal and apply it to all future cases where the facts are substantially the same. Not every opinion or judgment is regarded as binding: in order that an opinion or judgment may have the weight of a precedent two conditions must be fulfilled, 1) it must be an opinion rendered by a properly constituted court and 2) it must be an opinion the formation of which is necessary for a decision of a particular

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15 H. Bh thalack, The Principal of Stare Decisis, 34 AM. L. REG. 745, 745 (1886).
case, in other words it must not be an *obiter dicta*. However the rule of *stare decisis* is not a strict one: Courts can decline to follow their own previous decisions when those precedents are judged to be clearly in error. Lawyers and judges, moreover, regularly display—amazing ingenuity in “distinguishing” unfavorable precedents that otherwise would be “controlling.” And even in common law systems, the decisions of courts at the same level in the judicial hierarchy are not binding on each other, but only act as “persuasive precedents.” The purported values promoted by a system of *stare decisis* include stability, certainty and predictability, reliability, equality and uniformity of treatment, and convenience and expediency.

B. Civil Law

The concept of *stare decisis* does not exist in civil law. Most civil law countries relegate case law to the rank of a secondary legal source. However, in civil law systems, although the courts seldom acknowledge this, in practice precedents are recognized as providing strong force and can also be cited as providing further support for decisions that have other legally justifying grounds of the kind that may seem somewhat shaky, but for the assistance provided by the precedents. Thus courts in civil law countries developed the doctrine of *jurisprudence constante* – the doctrine under which the court is a required to take into account past decisions only if there is sufficient uniformity in the previous case law. According to Pierre Dupery:

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17 *Supra* note 13, at 134.
20 A precedent that is not binding on a court, but that is entitled to respect and careful consideration. For example, if the case was decided in a neighboring jurisdiction, the court might evaluate the earlier court’s reasoning without being bound to decide the same way – *BLACK’S LAW DICTIONARY*, (B. A. Garner et al. ed.s, 2004).
23 *Supra* note 13, at 134.
24 *Supra* note 22, at 4.
“while the rule of precedent is not recognized in French law, the significance of courts decision depends on the level of the jurisdiction. In general, courts tend to have a coherent approach in deciding cases, to avoid discrepancies. Nevertheless nothing prevents a lower court from making a decision that would contradict a decision made by a higher court.”

C. International Law

Public international law is based on the Roman civil law of continental Europe rather than on the English common law tradition. Therefore it is understood that there is no system of stare decisis or binding precedent in international law. Article 59 of the Statute of the International Court of Justice explicitly provides that “[t]he decision of the Court has no binding force except between the parties and in respect of that particular case.” Article 38 of the same statute provides that judicial decisions constitute only a subsidiary means of a determination of international law. However, according to Judge Mohamed Shahabudden though there is no rule of precedents binding in international law, it does not mean that there are no precedents and as a matter of fact the Court seeks guidance from previous decisions; “the Court uses its previous decisions in much the same way as that in which a common law court of last resort will treat its own previous decisions.”

Thus while there is no rule for binding precedents in international law, the ICJ does look to prior decisions for guidance. Similarly in the WTO there exists a de facto precedent. Recently the WTO Appellate Body in US – Stainless Steel (Mexico) explained the role of precedent in the WTO system by stating:


“Dispute settlement practice demonstrates that WTO Members attach significance to reasoning provided in previous panel and Appellate Body reports. Adopted panel and Appellate Body reports are often cited by parties in support of legal arguments in dispute settlement proceedings, and are relied upon by panels and the Appellate Body in subsequent disputes. In addition, when enacting or modifying laws and national regulations pertaining to international trade matters, WTO Members take into account the legal interpretation of the covered agreements developed in adopted panel and Appellate Body reports. Thus, the legal interpretation embodied in adopted panel and Appellate Body reports becomes part and parcel of the acquis of the WTO dispute settlement system. Ensuring “security and predictability” in the dispute settlement system, as contemplated in Article 3.2 of the DSU implies that in the absence of cogent reasons, an adjudicatory body will resolve the same legal question in the same way in a subsequent case.”

According to Professor Jackson while there is no stare decisis in jurisprudence of the WTO, there is certainly a very powerful precedent effect. Professor Jackson believes that panels or Appellate Body are not required to follow prior cases, except where there have been numerous cases resolving a particular issue and the resolution has been accepted by all Members, then a “practice under Agreement” as defined by the Vienna Convention may have a stronger precedential impact. However, “the “flavor” of the precedent effect in the WTO is still somewhat fluid, and possibly will remain fluid for the time being.”

While decisions of international courts and tribunals do not have a formal binding authority under international law, this point does not materially undermine the genuine and effective influence that runs from the broader understanding of precedent – one that does not require binding adherence to the prior decision. Thus, though the principals of international law do not contain a rule for binding precedent, in practice permanent tribunals, such as

31 Supra note 26, at 526.
the ICJ and the WTO panels and Appellate Body have followed a somewhat loosely formed rule of *de facto* precedents.

### III. Arguments Against Precedents in Investor State Arbitration

As stated above there is no rule of binding precedent in international law. However, international courts and tribunals do consider previous decisions to have at least persuasive value, if not considered as binding precedents. However, investment arbitrations, in contradistinction to the ICJ or WTO, are not conducted under the aegis of any permanent courts or tribunals. According to Schreuer:  

> “Investment arbitration takes place before *ad hoc* tribunals. Their composition varies from case to case. This makes it considerably more difficult to develop a consistent case law than in a permanent judicial institution such as the International Court of Justice (ICJ), The European Court of Human Rights (ECHR) or The Court of Justice of the European Communities.”

Further according Schill investor state arbitration does not incorporate the concept of *stare decisis* because, first some investment treaties explicitly provide for the ‘relative nature’ of awards and decisions in investor-State disputes.  

> “applying MFN clauses in this way is not possible because they apply only to more favorable treatment granted by the host State and thus require conduct that is attributable to the host State. The award of an arbitral tribunal, by contrast, is not attributable to the host State. MFN clauses, therefore, cannot operate with respect to decisions by international tribunals and produce the effect of establishing a system of precedent.”

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34 Ibid., at 290.
Third, and final, the procedural law governing investor-State disputes equally does not furnish a basis for establishing a system of *stare decisis*.

The ad hoc nature of investor state tribunals (like commercial arbitration) along with the variations in treaty wordings and obligations create difficulties in the development of consistent case law, and therefore precedents, in investor state arbitration. Hence, the question of whether there are precedents in international investment law is a complicated and nuanced one.

This section will examine some of the legal and practical difficulties in establishing a system of precedent or something akin to it in investment law. The section first compares international investment arbitration to international commercial arbitration and then sets out the legal norms in various conventions and rules dealing with investment arbitration that could be construed as creating a bar against precedent in investor state arbitration.

**A. International Commercial Arbitration and Investor State Arbitration**

Much like international commercial arbitration, ad hoc panels conduct investment arbitration. BITS and other investment treaties often provide for the jurisdiction of ICSID or its additional facilities or ad hoc arbitration under UNCITRAL, Stockholm Chamber of Commerce, ICC etc. ICSID, Stockholm Chamber of Commerce or ICC only provide for rules for the conduct of the arbitration, whereas the substantive provisions are contained in investment treaties, general principles of international law and the domestic law of the host country.

In many respects investor state arbitration has much in common with international commercial arbitration. Firstly both involve a claim by private party before a private tribunal. Second, investment arbitrations are many times governed by the same or similar rules as those governing international commercial arbitration. Given these similarities and the lack of a rule of

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35 *Supra* note 33, at 291.
36 *Supra* note 25, at 252.
precedents in international commercial arbitration\textsuperscript{38} it would seem only logical to conclude that the rule is similarly lacking in international investment arbitration.

However, investor state arbitration can be differentiated from international commercial arbitration. According to Harten and Loghlin:\textsuperscript{39}

\begin{quote}
\small
“it would be a mistake to confuse investment arbitration, pursuant to a treaty, with commercial arbitration. Commercial arbitration originates in an agreement between private parties to arbitrate disputes between themselves in a particular manner, and its authority derives from the autonomy of individuals to order their private affairs as they wish. Investment arbitration, by contrast, originates in the authority of the state to use adjudication to resolve disputes arising from the exercise of public authority. Investment arbitration is constituted by a sovereign act, as opposed to a private act, of the state and this makes investment arbitration more closely analogous to domestic juridical review of the regulatory conduct of the state.” (internal citations omitted)
\end{quote}

Also unlike awards issued in international commercial arbitrations, awards in investment arbitrations are often made public and publication is the first step towards the formation and use of precedents.\textsuperscript{40} Given these important differences it is necessary to study the existence or non-existence of binding precedent in international investment arbitration in isolation from international commercial arbitration.

\textbf{B. Rules against Precedent}

As mentioned above most investor state arbitrations are conducted under the ICSID convention or UNCITRAL rules etc. Article 53 of the ICSID convention states that:

\begin{quote}
\small
“The award shall be binding on the parties and shall not be subject to any appeal or to any other remedy except those provided for
\end{quote}

\textsuperscript{38} This is a hotly debated topic and beyond the scope of this paper.


\textsuperscript{40} This topic is dealt with on page 13, \textit{infra}.
in this Convention. Each party shall abide by and comply with the terms of the award except to the extent that enforcement shall have been stayed pursuant to the relevant provisions of this Convention.”

In a similar vein Article 32(2) of the UNICTRAL rules states that “The award shall be made in writing and shall be final and binding on the parties.”

Both these rules, which limit the scope of the awards by making them binding only to the parties to the dispute, may be read as excluding the rule of a binding precedent in investor state arbitration. Also nothing in the travaux preparatories of the ICSID convention suggests that the doctrine of stare decisis should be applied.41 However according to Gabrielle Kaufman Kohler “this does not appear to be an extremely convincing basis to deny the existence of any form of precedent in this field”.42

**IV. INVESTMENT ARBITRATION DECISIONS – EMERGENCE OF A NEW JURISPRUDENCE?**

Despite the limited scope of application of the decisions issued by the tribunals some consider these awards to constitute new investment law jurisprudence.43 Previous decisions, though, not binding on tribunals because of the absence of the rule of stare decisis, “exercise, as a matter of fact, strong extra-legal constraints upon subsequent tribunals.”44 According to Tai-Heng Cheng there are three reasons why precedents may exist in investor state arbitration:

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41 Supra note 32, at 11.
43 “A “consolidating jurisprudence,” an “international common law of investor rights,” “an investment jurisprudence,” or a “common legal opinion or jurisprudence constante” — these are just some of the labels that have been given to the burgeoning corpus of precedents emanating from ICSID and other investment treaty tribunals.” Supra note 12, at 135.
44 “That a special jurisprudence is developing from the leading awards in the domain of investment arbitration can only be denied by those determined to close their eyes.” See J. Paulsson, International Arbitration and the Generation of Legal Norms: Treaty Arbitration and International Law, 3(5) TRANSNAT’L DISP. MGMT. (2006).
45 Supra note 33, at 323.
“Firstly, arbitrators are often eminent practitioners and scholars. They are steeped in the methods of legal reasoning in domestic and international law, and will tend to apply these methods with which they are most familiar. To the extent that precedent is now a method of legal reasoning embedded in many legal systems, arbitrators will naturally operate within a system of precedent. Second, methods of legal reasoning in domestic legal systems are designed, *inter alia*, to promote the orderly exposition and development of domestic law. Arbitrators are acutely aware that international law should also be developed in an orderly fashion and thus would tend to apply the legal methods that promote such an orderly development of international law. The third reason may be less noble. Arbitrators reap significant reputational benefits among fellow arbitrators, lawyers and the college of international jurists if they render awards that are regarded as well reasoned.”

For the development of this jurisprudence, however, a few conditions must be fulfilled. This section will deal with some of the basic requirements needed to be satisfied for establishing a system of precedent and therefore investment law jurisprudence. First there would need to be publication of awards. Second there will need to be some similarity in the facts. Third there would need to be similarity in applicable law, i.e. terms of the treaties and principles of international law. Fourth the tribunal issuing the decision should be reliable and authoritative.

### A. Publication of Awards

As stated above the doctrine of *stare decisis* evolved from Bracton’s first collection of English decisions. Similarly for there to be an evolution of international investment law jurisprudence there needs to increased publication of awards. According to Fabien Gelinas “the only conceivable way of preventing a body of case law from developing in investment arbitration would be a total ban on publication”. ICSID and UNCITRAL rules do not allow for automatic publication of awards. Article 48(5) of the


46 *Supra* note 13, at 136.
ICSID convention provides that “the Centre shall not publish the award without the consent of the Parties”. Similarly Article 32(5) of the UNCITRAL Arbitration Rules provides that “the award may be made public only with the consent of both parties”.

However, regulation 22(1) of ICSID Administrative and Financial regulations provides that:

“The Secretary-General shall appropriately publish information about the operation of the Centre, including the registration of all requests for conciliation or arbitration and in due course an indication of the date and method of the termination of each proceeding.”

Similarly rule 48(4) of the ICSID Arbitration rules states that “The Centre shall not publish the award without the consent of the parties. The Centre shall, however, promptly include in its publications excerpts of the legal reasoning of the Tribunal.” Thus the ICSID rules do allow for limited transparency.

In reality, however, most awards are now available online. According to Jeffery Commission:47

“Investment treaty awards and decisions are now readily accessible and available from a number of sources, including but not limited to: (i) ICSID reports, and a number of other printed publications around the world, such as International Legal Materials, Journal de Droit International, and ICSID Review—Foreign Investment Law Journal; (ii) the World Bank’s ICSID website; (iii) dedicated investment treaty websites such as investment claims, NAFTA claims, investment treaty arbitration, and transnational dispute management; and (iv) online at commercial legal service providers such as Kluwer Arbitration, LEXIS, and Westlaw.”

Publication of awards increases awareness of previous holdings amongst the arbitrators and parties to the disputes. Such awareness can help prevent inconsistency between arbitral awards. In fact, as a rule publication of awards contributes to increasing consistency and predictability.48 Publication of

47 Supra note 13, at 136.
awards also fosters scholarly debate on many issues that turn out to be controversial in the holdings of the arbitral tribunals. For example this paper refers to opinions of academics on published decisions as well the decisions themselves to reach its conclusions. The work of legal scholars and the decisions themselves, in accordance with Article 38(1)(d) of the Statute of the ICJ, provide at least a subsidiary means of determination of rules of law. Therefore availability of documents contributes to the development of substantive standards of investment law through arbitral practice.

Publication of awards may also be necessary in public interest. A citizen of a state involved in an arbitration proceeding may be interested in the progress of the proceeding because on many occasions they deal with issues of great public importance and any damages or payments made as a consequence of awards issued by the tribunals are paid out of public money. In 2004 there were at least nine cases being considered in which foreign investors who have been awarded contracts to provide water and sewage services in developing countries have run into conflict with regulatory authorities, and have taken recourse to investor-state arbitration in an effort to resolve their differences. Secrecy in such issues of social and national importance would seem to be against public interest.

Thus publication of awards not only helps in developing a new corpus of jurisprudence but also is necessary for public interest purposes thereby adding a layer of legitimacy to the awards by providing transparency.

B. Similarity of Facts

Applying a precedent entails applying the legal reasoning in a previously decided case to a subsequent case. One of the most important ingredients for

49 Id.
50 Article 38(1)(d) says that “subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.”
51 Supra note 48.
53 Supra note 48, at 110.
a precedent to be applicable in such a manner is that the original decisions must have facts, which are identical or as nearly similar as possible to the pending case. According to Jeffery Commission, “while there is no requirement that the facts be identical, or the later case must be on “all fours” with the prior one, there needs to be sufficient factual similarities between the two cases to support the process of analogical reasoning.”54 In following precedents we should therefore leave the realm of absolute identity.55 Prior decisions establish a precedent for some different array of facts, ones that contain some points of identity with the facts of the prior decision.56 In the alternative, dissimilarity of facts may make the ruling of a prior case inapplicable in a subsequent case.

For investor state arbitration tribunals to develop binding precedents not only should the decisions be published, they must also cover a wide variety of fact and commercial circumstances that continue to occur in international business and in relation to foreign investments. Considering the growing number of investor state disputes there is a realistic possibility that many disputes may have identical, similar or overlapping factual issues. For example a considerable number of disputes arising in the wake of the Argentinean financial crisis could be considered to have some overlapping factual circumstance. For example “the state of necessity” defense was raised by Argentina in two disputes arising out of the same factual background, i.e. privatization of gas distribution industry, namely CMS Gas Vs Argentina57(CMS Gas) and LG & E Vs Argentina58(LG), in connection with obligations under the US-Argentina BIT.59

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54 Supra note 13, at 531.
56 Ibid, at 578.
59 However, the tribunals in these two cases reached contradictory conclusions. Whereas the CMS tribunal rejected the “state of necessity” defense, LG & E tribunal concluded that Argentina was indeed in a “state of necessity” and was therefore excused from non-performance of BIT obligations for 18 months.
C. Similarity in Applicable Law

For a decision to function as a precedent not only must it be based on similar facts, it is also of paramount importance that there should be similarity in applicable legal principles. According to Gibson and Drahozal “this is an element which receives most attention when considering limits of a prior precedent”60. They further state that if the law in two cases differs significantly in substance, there is a limit to the applicability of one case to another.61 This makes sense because if the law applicable to cases is different, then the legal rules and principles on which the holdings will be based will vary, and sometimes might be incompatible, and therefore the cases cannot be reconciled.

Looking at different treaties it appears that only a minority of investment treaties make the municipal law of a country the applicable law. In case of the absence of a provision selecting applicable law, the ICSID convention provides that “the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable”.62 Similarly Article 33(1) of the UNCITRAL Rules provides that “The arbitral tribunal shall apply the law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable”.

Article 42(1) has been interpreted to mean that in case of absence of a provision selecting applicable law international law is called upon to play a dual role in this case – i.e., to fill in the gaps of the applicable municipal law and amend the relevant contents in case the latter are incompatible with international law.63 The law, which applies to most of ICSID arbitrations and similar types of arbitrations, is a mixture of public international law, private international law (i.e. international conflict of laws64), and municipal law,

60 Supra note 26, at 532.
61 Supra note 26, at 532.
62 Article 42(1) of ICSID Convention.
64 See BLACK’S LAW DICTIONARY, supra note 20.
with all three types of law relevant to the resolution of particular disputes.\textsuperscript{65} Thus international law\textsuperscript{66} seems to provide a common thread in investor state arbitrations. According to Gibson and Drahozal investor state arbitral tribunals are required to enquire into municipal law only on rare occasions, thus the possibility of case law, being a limiting factor in the application of a precedent is diminished.\textsuperscript{67} Further even if municipal law is invoked, there may be a high degree of similarity in the principles of law, e.g. contracts, applicable in the nations of the world. According to some, recent BIT arbitrations accord a controlling role for international law, by providing the standard by reference to which the legality of the conduct of the host state is to be assessed.\textsuperscript{68}

One of the most important sources of law applicable in investment law are the investment treaties themselves. Most BITS contain specific substantive provisions, which are applicable in investor state arbitrations. These provisions enshrine the protections that are sought to be bestowed upon a foreign investment. Although each country has its own model BIT, virtually all BITS treat the same issues and there is a substantial degree of uniformity in the substantive provisions contained in the treaties.\textsuperscript{69} Thus, taking into account the vast web of BITS and their overlapping content, according to Schwebel “Customary international law governing the treatment of foreign


\textsuperscript{66} According to the Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, the term “international law” as used in this context should be understood in the sense given to it by Article 38(1) of the Statute of the International Court of Justice. Article 38(1) of the Statute of the ICJ: “The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:
  a. international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;
  b. international custom, as evidence of a general practice accepted as law;
  c. the general principles of law recognized by civilized nations;
  d. subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.”

\textsuperscript{67} Supra note 26, at 533.

\textsuperscript{68} A. Redfern, and M. Hunter, LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION 19 (2004).

investment has been reshaped to embody principles of law found in more than two thousand concordant bilateral investment treaties. With the conclusion of such a cascade of parallel treaties, the international community has fashioned an essentially uniform foreign investment law. However, it must be noted that each BIT has its own peculiar wording and that may affect the true meaning or scope of similar provisions and thus their interpretation.

According to some BITS principles of customary rules of international law are also an important source of law. However, there is a debate as whether some of these principles with respect of investments exist. The legal structure relating to protection of foreign investments in the post war era was seriously lacking because 1) applicable international law failed to take into account contemporary investment practices and address concerns of foreign investors, 2) principles of international law that did exist were vague and subject to varying interpretation, 3) the existing structure has prompted disagreements between developed and developing countries and finally 4) international law did not seem to provide adequate remedies to a disgruntled

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71 For a contrary opinion please refer to M. Sornarajah, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 232 (2004). According to Sornarajah, there would have been no need for international treaties if international law on investment protection had been clear.
72 For e.g. Article 5(1) of the US Model BIT provides, “Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security”. Similarly article 3(5) of the Netherlands–Czech Republic BIT provides that the countries will treat investments at least as well as required by “obligations under international law existing at present or established hereafter.” Agreement on Encouragement of Reciprocal Protection of Investments Between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic, Neth.-Czech Rep.-Slovak., art. 3(5) [hereinafter Netherlands-Czech Republic BIT], (June 6, 2010) http://www.unctad.org/sections/dite/iiia/docs/bits/czech_netherlands.pdf. The Canada–Poland BIT provides that investments “shall at all times be accorded fair and equitable treatment in accordance with principles of international law.” Agreement Between the Government of Canada and the Government of the Republic of Poland for the Promotion and Reciprocal Protection of Investments, Nov. 14, 1991, Can.-Pol., art. III(1), (June 6, 2010) http://www.unctad.org/sections/dite/iiia/docs/bits/canada_poland.pdf.
73 The developing countries challenged the principles of international investment law during the 1970’s. They used the United Nations as a platform for question the existence of the international law standards which sought to be imposed by the developed countries. Their position is best exhibited in article 2 of the Charter of rights and duties of states, adopted in 1974, which provided that every state would have sovereign rights to govern its natural and economic resources and could expropriate foreign investors property for a after payment “appropriate compensation” as opposed to “prompt, adequate and effective compensation”. Resolutions adopted by the General Assembly 3281 (XXIX). Charter of Economic Rights and Duties of States, 12 December 1974 (April 10, 2008) http://www.un-documents.net/a29r3281.htm.
Further there is uncertainty as to whether principles of customary international law can be used to determine obligations under a BIT. The issue of “state of necessity” arose in the disputes concerning gas distribution in Argentina. In the cases of CMS Gas and LG, Argentina invoked “state of necessity” defense under Article XI of the US-Argentina BIT. The tribunal in CMS Gas rejected Argentina’s defense referring to “necessity” under customary international law as expressed in Article 25 in the International Law Commissions Articles on State Responsibility. On the other hand the tribunal in LG referred to the express provisions in the BIT and upheld Argentina’s defense for a period of 18 months. Thus the two tribunals diverged on the use of customary international law to interpret treaty obligations.

D. Authority of Tribunals

Under common law for a decision to be a precedent, a judge appointed to a properly constituted court must make the decision. Also due to the hierarchy of courts, decisions of a judge in upper echelons are binding on lower ones. In the case of investor state arbitrations these requirements are not satisfied because ad hoc tribunals conduct the arbitrations and there is no hierarchy amongst the tribunals. As a result it would appear that decisions issued by tribunals would not be accepted as binding precedents because they arbitrators lack the authority to bind their peers. However, it will be shown below that the arbitrators do have “de facto” ability to establish persuasive precedents.

International arbitral awards can be seen as a source of international law under Article 38(1) d because they can be viewed as the equivalents of judicial decisions or pronouncements of the most highly qualified publicists. According to Jan Paulsson:

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75 Article XI provides that “This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the Protection of its own essential security interests.”

“One can hardly fail to remark that among the most frequently appointed members to international investment tribunal panels may be found former Presidents of the International Court of Justice (Guillaume, Schwebel, Bedjaoui), a former President of the WTO Appellate body and member of his country’s Supreme Court (Feliciano), a former President of the UN Security Council (Fortier), the rapporteur of the International Law Commission’s draft articles on state responsibility (Crawford), and the present and immediate past Presidents of the leading international arbitral institution of the International Court of Arbitration of the International Chamber of Commerce (Briner, Tercier). Indeed, the current President of the International Court of Justice (Higgins) chaired the oft-cited ICSID tribunal which decided the second Amco v. Indonesia case. The list could be extended to include numerous scholars and practitioners of international renown, but no more is needed, it seems, to conclude that among the authors of these awards are those who must surely qualify for consideration as “the most highly qualified publicists of the various nations”.

As a practical matter there could as be said to be a “bench” of investor state arbitrators.77 A review of 115 concluded ICSID arbitrations reveals 43 arbitrators accounted for 176 of the possible 361 appointments (49%).78 Further a review of the 103 pending cases shows that 32 arbitrators accounted for 153 appointments (54%).79 Thus there is a clearly consistent appointment of experienced and highly qualified arbitrators in ICSID arbitrations. This consistency adds one more layer of legitimacy to the decisions issued by the tribunals.

Given the fact that decisions of arbitral tribunals do, at least, constitute a subsidiary source of international law, coupled with consistency of appointments of high quality arbitrators, the decisions issued by these tribunals do carry some “authoritative value”. In sum it can be said, that while the current regime for investor state arbitrations does not, in the strictest sense,
satisfy all the major requirements for making binding precedents, it does satisfy enough of the requirements to make decisions which are at least persuasive.

V. Case Law

We have seen above that the tribunals instituted under the current regime of investor state arbitration do have some of the trappings required to issue decisions that could be persuasive precedents in subsequent arbitrations. This section will now look at the views of different arbitral tribunals to see if they view themselves as being bound by previous decisions.

Amco Corp Vs. Republic of Indonesia\(^{80}\) is the first publicly available decision to use the word “precedent”.\(^{81}\) In those proceedings the tribunal commented on the parties numerous references to and reliance upon the unpublished awards in the Holiday Inns case on the first decision on jurisdiction:

“To refer to the Holiday Inns award—in spite of the same not being a binding precedent in this case—here, this agreement is by no means implied…The tribunal will state again that in spite of superficial resemblances, the facts in the Holiday Inns case and in the instant one are largely different, so that the references to Holiday Inns are not really relevant, except that as in said case, the arbitrators extended an arbitration clause to parties which had personally executed it; accordingly, it would not seem to be contrary to that precedent(to the extent to which it is a precedent) to apply an arbitration clause.”\(^{82}\)

More recently in the case of Enron Corporation and Ponderosa Assets, L.P. Vs. Argentine Republic\(^{83}\) the tribunal held that “decisions of ICSID or other arbitral tribunals are not a primary source of rules”. The same tribunal

\(^{80}\) Amco v. Indonesia, ICSID Case No. ARB/81/1 (1984), (Decision on Jurisdiction).

\(^{81}\) Supra note 13, at 144.

\(^{82}\) Supra note 80, para.s 14 and 25.

\(^{83}\) Enron Corporation and Ponderosa Assets, L.P. v. The Argentine Republic, ICSID Case No. ARB/01/3 (Decision on Jurisdiction) at para. 40.
in an ancillary claim held that “the decisions of ICSID tribunals are not binding precedents and that every case must be examined in the light of its own circumstances”.84

The question of the authority of previous decisions came under strict scrutiny in the cases against Argentina in the wake of the financial crisis. Despite numerous decisions finding jurisdiction, Argentina steadfastly raised similar objections to jurisdiction over and over again.85 In the decision on jurisdiction in the resubmitted Vivendi case Argentina once again raised the question of whether the participation of foreign shareholders in a domestically owned company constituted an investment.86 The tribunal rejected Argentina’s case, and in order to bolster its reasoning added an appendix to its decision in which it listed previous decisions that had dealt with and rejected the same argument. The tribunal observed that similar objections had been raised by Argentina in 18 other cases and had been rejected every time, and that the last tribunal held that “this very objection which Argentina raises in this case has been made numerous times, never, so far as the Tribunal has been aware, with success”87

The question of “precedent” was discussed in much depth in the case of AES Corporation Vs. Argentina.88 In this case the claimant pointed out that all the objections raised by Argentina with respect to jurisdiction had been consistently rejected by other tribunals.89 The tribunal however noted that:

“There is so far no rule of precedent in general international law; nor is there any within the specific ICSID system for the settlement of disputes between one State party to the Convention and the National of another State Party. This was in particular illustrated by diverging positions respectively taken by two ICSID tribunals

85 Supra note 32, at 12.
86 Compañía de Aguas del Aconquija S.A & Vivendi Universal v. Argentine Republic, ICSID Case No. ARB/97/3 (2001), (Decision on Jurisdiction) at para. 10.
87 Supra note 86, at para. 94.
88 AES Corporation v. The Argentine Republic, ICSID Case No. ARB/02/17 (2005), (Decision on Jurisdiction).
89 Ibid., at para. s 17 & 18.
on issues dealing with the interpretation of arguably similar language in two different BITs. As rightly stated by the Tribunal in SGS v. Philippines, although different tribunals constituted under the ICSID system should in general seek to act consistently with each other, in the end it must be for each tribunal to exercise its competence in accordance with the applicable law, which will by definition be different for each BIT and each Respondent State.90

It should be noted that the tribunal states that there is “so far” no rule of precedent, leaving the door open for future reconsideration of the topic. The Tribunal then referred to the decision in the Enron case, which has been mentioned above.91 The tribunal then pointed out:

“That each BIT has its own identity; its very terms should consequently be carefully analyzed for determining the exact scope of consent expressed by its two Parties.

This is in particular the case if one considers that striking similarities in the wording of many BITs often dissimulate real differences in the definition of some key concepts, as it may be the case, in particular, for the determination of investments or for the precise definition of rights and obligations for each party.”92

Thus the tribunal concluded firstly that findings of law made in one case, of the terms of a BIT, are not necessarily relevant in other cases and secondly that Argentina is allowed to raise similar objections in successive arbitrations.93 However the tribunal went on to conclude:

An identity of the basis of jurisdiction of these tribunals, even when it meets with very similar if not even identical facts at the origin of the disputes, does not suffice to apply systematically to the present case positions or solutions already adopted in these cases. Each tribunal remains sovereign and may retain, as it is confirmed by ICSID practice, a different solution for resolving the same problem; but decisions on jurisdiction dealing with the same

90 Supra note 88, at para. 23.
91 Supra note 83.
92 Supra note 88, at paras. 24 and 25.
93 Supra note 88, at para. 26.
or very similar issues may at least indicate some lines of reasoning of real interest; this Tribunal may consider them in order to compare its own position with those already adopted by its predecessors and, if it shares the views already expressed by one or more of these tribunals on a specific point of law, it is free to adopt the same solution.94

Thus even though the tribunal rejected the rule of precedent it did not bar the possibility of development of the rule in the future. The tribunal also recognized that while ICSID tribunals are not bound by previous decisions, those decisions may at least “indicate some lines of reasoning of real interest”. It is interesting to note in this case, that even when rejecting the rule of precedent the tribunal refers to previous decisions for guidance.95

In some cases ICSID tribunals do not make reference to a doctrine or rule of precedents and simply refer to cases and precedents throughout, and do not make any efforts to disguise their outright reliance on previous cases.96 For example in the CMS Gas97 case the tribunal first refers to the Lanco Case98 and then says that “The task of the Tribunal is again rendered easier by the fact that a number of recent ICSID cases have had to discuss and decide on similar or comparable provisions concerning contracts and the scope of the Treaty.”99

In some cases, much like the appendix in the aforementioned Vivendi case, tribunals have dedicated portions or sections of their decisions, typically a paragraph, labeled “opening considerations”, “introductory matters” etc.,

94 Supra note 88, at para. 30.
95 The Tribunal refers to SGS v. Philippines and Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic decisions to reach in reaching its conclusion that “in the hearing on jurisdiction held in respect of this dispute, to the effect that the decisions of ICSID tribunals are not binding precedents and that every case must be examined in the light of its own circumstances” - Supra note 86, at para. 23.
96 Supra note 13, at 146.
98 Ibid., at para. 63.
99 Supra note 97, at para. 72.
100 Supra note 13, at 147.
to the study of previous decisions. In some of these cases the tribunals accept that while there is no precedent, tribunals still respect prior decisions. Thus the tribunal in *El Paso* held:

“ICSID arbitral tribunals are established ad hoc, from case to case, in the framework of the Washington Convention, and the present Tribunal knows of no provision, either in that Convention or in the BIT, establishing an obligation of *stare decisis*. It is, nonetheless, a reasonable assumption that international arbitral tribunals, notably those established within the ICSID system, will generally take account of the precedents established by other arbitration organs, especially those set by other international tribunals. The present Tribunal will follow the same line, especially since both parties, in their written pleadings and oral arguments, have heavily relied on precedent.102

In the case of *Jan De Nul* the tribunal held, “The Tribunal considers that it is not bound by earlier decisions, but will certainly carefully consider such decisions whenever appropriate.” Thereafter the tribunal follows *Bayindir Vs. Pakistan*.105

There have, however, been cases in which conflicting decisions have passed on identical or similar questions of law or fact. For example the “umbrella clause” has been a source of much debate. Decisions in *SGS Vs. Philippines* and *SGS Vs. Pakistan* are clearly inconsistent. In *SGS Vs. Pakistan* the tribunal opined that the placement of the clause near the end of the Swiss-Pakistan BIT, in the same manner as the Swiss Model BIT, was indicative of an intention on the part of the Contracting Parties not to provide

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102 Supra note 100, at para. 39.
104 Ibid., at para. 64.
105 Supra note 103, at para. 71.
106 SGS Société Générale de Surveillance S.A. v. Republic of the Philippines, ICSID Case No. ARB/02/6 (2004), (Decision on Objections to Jurisdiction).
107 Id.
a substantive obligation. 108 The Tribunal considered that had the Contracting Parties intended to create a substantive obligation through the umbrella clause it would logically have been placed alongside the other so-called “first order” obligations. 109 By contrast, the SGS Vs. Philippines Tribunal opined that while the placement of the clause may be “entitled to some weight,” it did not consider this factor as decisive. 110 In this respect, the Tribunal stated “it is difficult to accept that the same language in other Philippines BITs is legally operative, but that it is legally inoperative in the Swiss-Philippines BIT merely because of its location”. 111 According to Gabrielle Kaufman-Kohler:

“A review of the relevant decisions raises three considerations. First, there would seem to be a significant inconsistency between the two SGS awards. Secondly, there are a number of decisions that adopt a restrictive approach towards umbrella clauses, such as Salini v. Jordan, Joy Mining v. Egypt, and more recently the El Paso v. Argentina and Pan American v. Argentina decisions, which stated that:

an umbrella clause cannot transform any contract claim into a treaty claim, as this would necessarily imply that any commitments of the State in respect to investments, even the most minor ones, would be transformed into treaty claims.

Thirdly, the analysis reveals that other tribunals, such as the ones in Eureko v. Poland, Noble Venture v. Romania and Siemens v. Argentina have adopted the opposite view and have accepted that the concept of an umbrella clause is usually seen as transforming municipal law obligations into obligations directly recognizable in international law. In sum, the tribunals are divided when it comes to the umbrella clause, and no clear rule has emerged. Some tribunals have noted that their decisions were dependent on the terms of the bilateral investment treaty (BIT) involved. However, this explanation does not provide a satisfactory justification for all of the discrepancies.”

108 Ibid., at para. 169.
109 Supra note 107, at para. 170.
110 Supra note 106, at para. 125.
111 Supra note 106, at para. 124.
112 Supra note 42, at 369.
There have also been decisions, which reached contradictory conclusions on the same facts. Recently in a case involving the Czech Republic two independent treaty claims were made by a broadcasting firm (CME) and its major shareholder (Ronald Lauder). Two separate tribunals examined nearly identical issues and yet managed to reach completely contradictory conclusions as whether the Czech Republic had violated its obligations relating to non-discrimination and expropriation. Thus according to well-known Swiss arbitrator Jacque Werner investor state arbitration is at risk of becoming a “legal casino”.

These cases highlight very different approaches to precedents by the tribunals. Some tribunals have denied the existence of a rule of precedent, others have followed previous precedents but have not discussed the existence or nonexistence of the rule of precedent, while other have accepted the absence of the rule of precedent and even then discussed and referred to previous decisions in reaching their conclusions and in some cases parties have referred to previous decisions but the tribunals have refused to follow the cited cases due to a lack of rule of precedent. Some cases have even issued completely contradictory decisions on identical points. These various approaches, however, seem to, more or less, present a common theme that even though there is no rule of precedent, previous decisions have been referred (even to question the existence of a rule of precedent) in many cases.

Citation analysis conducted by some seems to support this conclusion. Gibson and Drahozal conducted a study to see how often decisions of the Iran–United States Claims Tribunal have been cited by ICSID tribunals. They concluded that 17 out of 38 (44.7%) of the ICSID decisions on merits cited the Tribunals precedent. According to a study conducted by Jeffery Commission the use of precedents in investor state arbitration under the aegis of ICSID has increased dramatically since 2001. According to him in 2006 ICSID tribunals decisions on jurisdiction contained on an average 11.25

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113 Supra note 42, at 27.
115 Supra note 26, at 540.
116 Supra note 13, at 149.
citations of previous ICSID awards, whereas in the same year ICSID final awards contained 9.3 citations to ICSID awards.117 Jeffery Commission further shows that non-ICSID tribunals, such as those constituted under UNCITRAL rules, LCIA arbitrations etc., contained on an average 18.43 citations to previous treaty awards and decisions.118

VI. Conclusion

Precedents allow for the development of the law, but also make development constrained by the past. However, at the same time if the decisions of a tribunal are to be used as precedents in the future they must constrain the present. As one eminent scholar says:

“An argument from precedent seems at first to look backward. The traditional perspective on precedent, both inside and outside of law, has therefore focused on the use of yesterday’s precedents in today’s decisions. But in an equally if not more important way, an argument from precedent looks forward as well, asking us to view today’s decision as a precedent for tomorrow’s decision makers. Today is not only yesterday’s tomorrow; it is also tomorrow’s yesterday. A system of precedent therefore involves the special responsibility accompanying the power to commit the future before we get there.”119

Such an effect of precedent does not exist in investor state arbitrations. Whereas tribunals are examining precedents, to make reasoned and consistent decisions, they must at the same time remain true to the unique wording of each BIT. As ad hoc tribunals their responsibility lies primarily to the parties appointing them.

In this sense the use of precedents in investor arbitration does not seem to point towards a definitive rule of binding precedent. However, neither does the practice preclude in toto the use the precedents. As the tribunal in AES Corporation put it – “decisions … with the same or very similar issues may

117 Supra note 13, at 150.
118 Supra note 13, at 151.
119 Supra note 55, at 572.
at least indicate some lines of reasoning of real interest.”¹²⁰ Precedents appear to have a limited but powerful precedential value. This approach places responsibility on lawyers and decision makers in investor state arbitrations to review prior cases thoroughly to determine if they sufficiently analogous to facts in hand, and whether such a prior precedent will actually help in the final determination of the proceedings.¹²¹ In the current economic climate with countries tethering on the brink of bankruptcy and the possibility of a slew of new investor-state related disputes, precedents could have a significant bearing on the not only the development of investor-state jurisprudence, but the fate of entire countries.

¹²⁰ Supra note 88.
¹²¹ Supra note 26, at 544.
Anti-dumping Agreements and Exhaustion of Local Remedies

Dr. A. Jayagovind

Abstract

Article VI of the GATT, 1947, for the first time, sought to standardize national anti-dumping laws by reference to international standards. The Kennedy Round and Tokyo Round Codes on anti-dumping further refined the concepts and provided procedural safeguards so as to curb the arbitrariness of national administrative authorities. The Uruguay Round produced a comprehensive anti-dumping code providing for judicial review of administrative action imposing anti-dumping duties on imported goods. But it is noticed that exporting countries often resort to the dispute settlement body of the WTO without exhausting judicial remedies provided by the legal system of the importing countries. This article argues that this bypassing of judicial remedies is a violation of Public International Law.

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I. Introduction

Among all international institutions, the World Trade Organization (WTO) has the most effective and credible system of settlement of disputes between member states. The dispute settlement mechanism embodied in the Agreement on Dispute Settlement Understanding (DSU), forming part of the WTO system, has often been hailed as the ‘crown jewel’ of the regime governing international trade. It will be interesting to consider the interface between the traditional international legal doctrine of exhaustion of local remedies and settlement of disputes under the WTO. Going back to 1947, when the General Agreement on Tariffs and Trade (GATT) was adopted, the relevance of the ‘local remedies rule’ to the GATT/WTO regime was raised only in the context of the provisions governing anti-dumping measures under the GATT and presently under the WTO.²

The doctrine of exhaustion of local remedies is concerned with the treatment of foreigners by the host governments. Among the Multilateral Trade Agreements (MTAs) constituting the WTO system, the Anti-Dumping Agreement (ADA) (i.e. “Agreement on Implementation of Article VI of the GATT 1994” as per the WTO terminology) is the only agreement under which foreigners are subjected to adverse treatment by host governments for the conduct attributable to them. In other words, the importing country can impose anti-dumping duty on the products dumped by foreign traders. In the case of two other trade remedies, namely, countervailing and safeguard measures, the foreign traders suffer the consequences of the acts attributable to their home and host governments. Countervailing duties are levied on imported products to counterbalance the subsidies given by the home governments of exporters. Safeguard measures are imposed on imported products to help the domestic industries tide over their own problems. Against this background, it is surprising that the application of the local remedies rule was contested precisely in the context of ADA. The issue was officially raised for the first time by a GATT Panel in the United States: Anti-Dumping Duties on Gray Portland Cement and Cement Clinkers from Mexico.³ The relevant observations of the Panel are as follows:

² For a general discussion on these issues, see Rustel Silvestre J. Martha, World Trade Dispute Settlement and Exhaustion of Local Remedies Rule 30(4) JOURNAL OF WORLD TRADE 107-30 (1996).
³ ADP/82 (September 7, 1992).
The Panel further noted that in respect of administrative proceedings in the U.S., there was nothing in the Agreement which explicitly required the exhaustion of administrative remedies, i.e. that for an issue to be properly placed before a Panel, it would have had to have been raised in the domestic administrative proceedings. The Panel considered that if such a fundamental restriction on the right of recourse to the Agreement’s dispute settlement process had been intended by the drafters of the Agreement, they would have made explicit provisions for it. The Panel noted that Article 15.5 provided that the Committee “shall establish a panel to examine the matter, based upon: …(b) the facts made available in conformity with appropriate domestic procedures to the authorities of the importing country”. The Panel observed that this provision did not require the exhaustion of administrative remedies, but provided that the matter examined by the Panel would have to be based on the facts raised in the first instance, in conformity with the appropriate domestic procedures, in the administrative proceedings in the importing country.4

It may be noted that this case was based on the Tokyo Round Code which did not mandate the judicial review of administrative decisions concerning dumping. In fact, international anti-dumping law evolved within the framework of the GATT, 1947 to counteract the abuse of anti-dumping law by the domestic authorities of importing countries. Thus Article VI of the GATT, 1947, defined dumping authoritatively for the first time and required ‘material injury’ as a condition precedent for imposing anti-dumping duties. The Kennedy Round Code and Tokyo Round Code elaborated the administrative procedures to be followed by the domestic authorities of importing countries. The Uruguay Round Code, as will be shown, introduced, for the first time, judicial review of administrative decisions imposing anti-dumping duties. In the context of the Tokyo Round Code, it was correct to say that it did not mandate exhaustion of local remedies, generally associated with judicial safeguards.

Articles 5 and 6 of the Tokyo Round Code laid down the standards to be followed by administrative authorities while investigating the complaints

4 Ibid. at para. 5.9
concerning dumping. The central issue in this case was whether Mexico could raise certain arguments concerning “standing” (i.e. whether the American complainants represent American domestic industry as per Article 4 of the Agreement) and “cumulation” (i.e. the U.S. administrative authority’s decision to assess the impact of imports from Mexico cumulatively with imports from Japan). The U.S. argument was that these issues were not raised before the U.S. administrative authorities by Mexico and hence they could not be raised before the Panel for the first time. The Panel ruled that Mexico could raise these issues de novo, provided they were based on the “facts made available to the authorities of importing countries”; Mexico’s arguments were based on such facts.

It may be noted that as per Article 5 of the Tokyo Round Code, the function of administrative authorities was to investigate the existence, degree and effect of any alleged dumping. Article 6, titled ‘Evidence’, shows that the administrative authority is essentially engaged in investigation of facts, for Article 6 uses the expression “information” to be supplied by the parties. The implication is that the administrative authority is engaged in the investigation of facts and legal arguments, if any, would be incidental to questions of fact.

Article 13 of ADA, forming part of the WTO Agreement, reads:

Each member whose national legislation contains provisions on anti-dumping measures shall maintain judicial, arbitral or administrative tribunals or procedures for the purpose, *inter alia*, of the prompt review of administrative actions relating to final determinations within the meaning of Article 11. Such tribunals and procedures shall be independent of authorities responsible for the determination or review in question.

The above article provides for what we call in Common Law parlance the judicial review of administrative action. It is in perfect consonance with the international legal requirement of exhaustion of local remedies. But there exists a loophole in Article 17.4 of the ADA, which reads:

If the Member that has requested consultation considers that the consultations…have failed to achieve a mutually agreed solution, and if final action has been taken by administering authorities of
the importing Member to levy definitive anti-dumping duties or to accept price undertakings, it may refer the matter to the Dispute Settlement Body (DSB). When a provisional measure has significant impact and the Member that requested consultations considers that the measure taken is contrary to the provisions of paragraph 1 of Article 7, that member also may refer the matter to the DSU. (Emphasis added)

The above provision is often construed literally and the governments of exporting countries often rush to DSB once the administrative authorities of importing countries decide to levy anti-dumping duties bypassing judicial authorities. Surprisingly, this bypassing of judicial authorities was never questioned in the WTO proceedings by the respondents (i.e. the importing countries). It is humbly submitted that this bypassing amounts to violation of Public International Law relating to exhaustion of local remedies and right of diplomatic protection.

II. The WTO as an International Institution

The WTO text assiduously avoids the expression ‘Public International Law’. The closest it comes to this expression is in Article 3.2 of the DSU, which provides that the WTO text shall be interpreted “in accordance with customary rules of interpretation of public international law”. Practically every panel report ritualistically quotes this provision and refers to Article 31 of the Vienna Convention on the Law of Treaties as the expression of customary rules of interpretation of Public International Law.

In many cases, such as the Beef-Hormone Case between the USA and the EC, the question was raised whether the WTO is bound by the general principles of International Law, such as the precautionary principle. The panels dodged the issue, but were categorical that the so-called general principles of Public International Law cannot override the specific provisions of the WTO. In brief, they take the position that WTO agreements are lex

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5 This is based on information given by Indian lawyers engaged in practice in this area.
7 Ibid, at para. 8.158.
specialis within whose framework the disputes have to be decided. No specific provision of the WTO can be overridden by reference to the general principles of International Law.

Article 31 of the Vienna Convention, which has been repeatedly relied upon by the panels, also contains paragraph 3(c), which provides that while interpreting a treaty:

There shall be taken into account, together with the context: any relevant rules of international law applicable in the relations between the parties.

Exhaustion of local remedies is definitely a fundamental rule applicable in relations between states and all MTAs forming part of the WTO must be interpreted keeping this fact in mind. Of course, it is well recognized that states can waive the requirement of exhaustion of local remedies if they so choose. For example, under International Convention on Settlement of Investment Disputes (ICSID) arbitrations, the local remedies rule will not apply unless the host state makes it an express condition of its consent while adhering to the Convention. This is so because of Article 26 of the Convention. In the context of the ADA, the relevant question is whether member states have specifically waived the requirements of exhaustion of local remedies and whether Art. 17.4 can be so interpreted.

**III. Exhaustion of Local Remedies**

A state would incur international responsibility if there is a denial of justice to foreigners and this denial of justice takes place if it administers justice to aliens in a fundamentally unfair manner. In other words, a state is under an international obligation to create and maintain a system of justice which ensures that unfairness to a foreigner either does not happen, or is corrected. It is the whole system of legal protection as provided by the municipal law which will be put to test when the denial of justice is alleged.8

The exhaustion of local remedies is a precondition for denial of justice in the sense that a foreigner is equally duty-bound to avail all the remedies provided under the municipal system to get justice. If the foreigner concerned fails to

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8 Jan Paulson, *Denial of Justice in International Law* 4-10 (2007).
get justice even after exhausting local remedies, he may appeal to his home state to take up his case with the host state at international level. Relying upon the international legal maxim: “injury to its national is finally injury to the state”, the state concerned can take up the matter in exercise of its right of diplomatic protection.

Given the complex governing structure and the process of decision-making of any given state, a wrong committed by an official cannot be attributed to the state, unless the government is given an opportunity to deliberate on it and take appropriate action. In other words, to attribute a wrong of an official to the state, it is necessary for the victim of the wrong to exhaust the available local remedies. As the International Court of Justice put in the Interhandel Case:

“The rule that the local remedies must be exhausted is a well-established rule of customary international law. The rule has been generally observed in cases in which a State has adopted the cause of national, whose rights are claimed to have been disregarded in another state in violation of International Law. Before resort may be had to an international court in such a situation, it has been considered necessary that the State where the violation occurred should have an opportunity to redress it by its own means within the framework of its domestic legal system.”

Under any constitutional system of governance, these local remedies are provided by judicial institutions independent of executive branch responsible for causing the injury. If the judiciary fails to deliver justice, there would be “denial of justice” by the State. This is so, since from international point of view, the judiciary is a constituent of the State; its failure to deliver justice will thus be attributed to the State. Given the hierarchical structure of the judiciary designed to avoid the possibility of miscarriage of justice by human frailty, the judgment, to be attributable to the State, must be that of the final court. As Judge Jiminez de Archega put it:

“An essential condition of a State being held responsible for a judicial decision in breach of municipal law is that the decision must be the decision of court of last resort, all remedies having been exhausted.”

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The idea of justice signifies that a person must get what is due to him. Therefore, denial of justice to a foreigner means the deprivation of his entitlements as a result of an action attributable to the State. These entitlements are recognized and enforced as rights under a functional legal system. These rights may have their origin either in municipal law or in International Law. But, insofar as these rights have their origin in International Law, it is necessary that such rights are incorporated in national legal system administered by local courts. The local remedies rule has no application if these rights are not transformed into municipal law rights; in such cases, the executive branch of the government has to account for any breach thereof at the international level.11

IV. THE WTO AND THE RIGHTS OF FOREIGNERS

The basic premise of the GATT/WTO is that international commercial transactions are essentially carried out by private individuals or entities. Tariff concessions have no meaning if governments carry on all import-export transactions. Viewed from this angle, one can argue that the WTO has sought to establish and ensure “right to trade” on the part of private individuals under International Law; this right may be considered as the realization of the economic rights recognized by International Covenant on Economic, Social and Cultural Rights, 1966. Whenever this right (as defined by the constituent agreements of the WTO) is violated by an action attributable to a foreign state (i.e. the state other than home state of the private party concerned), it can give rise to an international cause of action under the WTO. Insofar as such violations can be properly redressed by the domestic legal system, the foreigner concerned is expected to exhaust the available local remedies. But, most of the time, and probably in most cases, the violation of the right to trade may be the result of the policy decisions taken at the highest level and local remedies may not be available or appropriate under those circumstances. The DSU provides the mechanism to settle such disputes at the international level.

11 There are very few countries in the world wherein municipal courts can directly enforce rights derived from International Law. In such cases, the affected foreigners have to exhaust local remedies.
Most of the MTAs of the WTO require the member states to take necessary legislative actions to implement their obligations in their territories. Especially in the context of trade remedies, namely, anti-dumping, countervailing and safeguard measures, the agreements lay down elaborate procedures which have to be incorporated in the domestic legal system. The result is that national institutions, while applying their own laws, are implementing international obligations as well. It is reasonable to assume, in light of the above analysis, that all available domestic remedies must be exhausted before resorting to the WTO’s dispute settlement mechanism. In brief, all member states of the WTO are obligated to protect the right to trade of foreign traders as per the provisions of the MTAs.

The first anti-dumping statute was passed by Canada in 1904 to counteract dumping of steel by the U.S. This was followed by New Zealand (1905), Australia (1906) and South Africa (1914). In the beginning, the USA treated anti-dumping as part of its anti-trust law, but it adopted the proper Anti-dumping Act in 1921. All these national legislations vested power in administrative authorities without leaving any scope for affected foreign traders to challenge their decisions. As pointed out above, International Law on anti-dumping, initiated by the GATT in 1947, sought to regulate national discretion in this regard. The Kennedy Round and Tokyo Round Codes prescribed the procedures to be followed by administrative authorities and the Uruguay Round Code, for the first time, provided for judicial review of administrative decisions. The local remedies rule hardly had any application till the Kennedy Round Code, since there was no local remedy at all. We have full-fledged local remedy provisions for the first time under the Uruguay Round Code.

V. The Anti-Dumping Agreement

A literal reading of Art. 17.4 of the ADA may lead to the conclusion that the home state of the exporter may approach the DSB once “the final action has been taken by the administrative authorities” without testing the legality of such administrative actions before a court of law. It may be noted that Art.

17.4 is substantially analogous to Art. 15.3 of the Tokyo Round Code. Apparently, like so many other provisions of the Tokyo Round Code, Art. 15.3 also found its way into the WTO Code with a few appropriate changes necessitated by the new institutional framework. The drafters failed to adequately appreciate the significance of the introduction of Art. 13, for the first time providing for judicial review of administrative action in international anti-dumping law, which had been evolving over a period of time. It must be noted that allowing the home state of an exporter to challenge an administrative action before the WTO, bypassing the national judicial review provided under Art. 13 amounts to defeating the *raison d’être* of momentous change ushered in by Art. 13.

Art. 31.1 of the Vienna Convention on the Law Treaties, often quoted by the panels, reads:

> A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

The clause in Art. 17.4, “if final action has been taken by administering authorities of importing countries…”, must be interpreted in the context of the newly introduced Art. 13, keeping in mind the objects and purposes of the WTO Agreement. This is perfectly in consonance with Art. 31.3 (C) of the Vienna Convention, which requires that the relevant principles of International Law applicable between the parties must also be taken into account while interpreting treaty provisions.

As was pointed out already, before attributing an act committed at a relatively lower level of official hierarchy to the State, the State must be given adequate opportunity to apply its mind and redress the grievance. It is only at that stage that such an act can be properly attributed to the State and that is the very purpose of the doctrine of exhaustion of local remedies. Applying the same logic, the expression “final action by administering authorities” must be understood in the light of Art. 13 i.e. only after the final administrative decision has been subjected to judicial scrutiny and upheld by the judiciary can the act be considered an act of the State. It is submitted that focusing only on “final action” in Art. 17.4, ignoring the context, would be a violation of Art. 31 of the Vienna Convention.
There is an authority for the above approach in international investment jurisprudence. As was pointed out earlier, under Art. 26 of the Convention on the Settlement of Investment Disputes (ICSID), the local remedies rule is not a condition precedent for resorting to international arbitration, unless the host state specifically demands it. In an ICSID award of 2003, namely, *Generation Ukraine, Inc. Vs. Ukrain*, the scope of Art. 26 was considered in detail. In this case, there was a bilateral investment treaty (BIT) between the USA and Ukraine and the treaty was silent about the requirement of local remedies. This was considered as the waiver of the local remedies rule. In this case, Generation Ukraine Inc. was a subsidiary of a US Construction company and was engaged in several construction works in Kyiv City. In the course of its work, it had to face several administrative and regulatory hurdles created by Kyiv City Administration. Generation Ukraine, Inc. treated this as indirect expropriation and invoked the international arbitration clause straight away, without availing of the local judicial remedies. The Tribunal ruled:

The claimant did not attempt to compel Kyiv City State Administration to rectify the alleged omissions in its administrative management by instituting proceedings in Ukrainian courts. This Tribunal does not exercise the function of an administrative review body to ensure that municipal agencies perform their tasks diligently, conscientiously and efficiently. That function is within the proper domain of domestic courts and tribunals that are cognizant of the minutiae of the applicable regulatory regime. There is of course no formal obligation upon the claimant to exhaust local remedies before resorting to ICSID arbitration pursuant to the BIT between the USA and Ukraine. Nevertheless, in the absence of any per se violation of the BIT discernible from the conduct of Kyiv City State Administration, only possibility in this case for the series of complaints relating to highly technical matters of Ukrainian planning law to be transformed into a BIT violation would have been for the claimant to be denied justice before Ukrainian courts in a bonafide attempt to resolve those technical matters.

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14 *Ibid.* paras. 20, 33
VI. THE ANTI-DUMPING AGREEMENT AND EXHAUSTION OF LOCAL REMEDIES

Article VI of the GATT, 1947 for the first time sought to standardize national anti-dumping laws by reference to international standards. The Kennedy Round and Tokyo Round Codes on anti-dumping further refined the concepts and provided procedural safeguards so as to curb the arbitrariness of national administrative authorities. The Uruguay Round produced a comprehensive anti-dumping code providing for judicial review of administrative action imposing anti-dumping duties on imported goods. But it is noticed that exporting countries often resort to the dispute settlement body of the WTO without exhausting judicial remedies provided by the legal system of the importing countries. This article argues that this bypassing of judicial remedies in violation of Public International Law.

Under the ADA, the administrative authorities investigate the complaints relating to dumping and take decisions in accordance with national anti-dumping laws which are expected to be in conformity with the ADA. These decisions are not taken at such a high level as to be attributable to the State directly. The purpose of Art. 13 of the ADA is to ensure that these administrative decisions are in conformity with the law. Given the complexity of anti-dumping law, these administrative decisions cannot be prima facie considered as violations of the ADA. Following the logic of of the Generation Ukraine Case, the denial of justice cannot be presumed in the absence of judicial review of administrative decisions. In brief, “final action to levy anti-dumping duties”, envisaged in Art. 17.4, can materialize only after the “final determination” of administrative authorities have been upheld by the judiciary under Art. 13. The distinction between “final determination” under Art. 13 and “final action” which would follow “final determination” after the approval of the “final determination” by the judiciary under Art. 17.4 emphasises the need for exhaustion of local remedies.

The judgment of the International Court of Justice (ICJ) in the case concerning Electronica Sincula S.P.A.\textsuperscript{15} supports the above conclusion. In

\footnote{U.S.A. v. Italy, ICJ Reports (1989) 1.}
this case, which, incidentally, deals with the issue of the exhaustion of local remedies, the U.S.A. brought an action against Italy on the basis of the Friendship, Commerce and Navigation Treaty concluded between them in 1948. The relevant provision of the Treaty, relied upon to support the jurisdiction of the ICJ, reads as follows:

Any dispute between the High Contracting Parties as to interpretation or application of this Treaty which the High Contracting Parties shall not satisfactorily adjust by diplomacy shall be submitted to the ICJ, unless the High Contracting Parties shall agree to settlement by some other specific means.

The cause of action in this case arose out of the actions of the Italian Government, injuring the investments of American company Electronica Sincula in Italy. When Italy raised the preliminary objection that the American investor had not exhausted local remedies, the U.S.A. took the stand that the treaty provision quoted above dispensed with such a requirement. In other words, if the dispute could not be settled by diplomacy, there was no need for resorting to local remedies; the above provision must be taken as a waiver clause.

The ICJ, while agreeing that the local remedies rule can be waived by the agreement, refused to treat the above provision as waiver. On this point, it ruled:

The Chamber finds it unable to accept that an important principle of customary international law should be held to have been tacitly dispensed with in the absence of any words making clear an intention to do so.16

Applying the same logic, it is clear that Article 17.4 cannot be interpreted as a waiver clause in the absence of categorical expressions to that effect.

One omission in Art. 13, when it is compared with Art. 17.4, is that Art. 13 does not specifically provide for the review of provisional measures as well. Normally, judicial review follows final administrative decisions; the

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16 Ibid. para. 50.
drafters probably followed this general principle, overlooking the possibility of review of provisional measures. Following the arguments developed above, once the national legislation provides for judicial review of provisional measures, exhaustion of local remedy would cover the review of provisional measures by the judiciary as well.

**VII. STANDARD OF REVIEW**

The ADA is the only MTA of the WTO containing a distinct standard of review to be used by panels while settling disputes. Art. 17.6 paragraphs (i) and (ii) lay down this distinct standard in relation to facts and law respectively. It may be noted that Part V of the Agreement on Subsidies and Countervailing Measures, laying down the investigation procedure in the context of countervailing duties, contains more or less identical provisions as that of the ADA. But it does not contain provisions similar to Art. 17.6 (i) and (ii). A Ministerial Decision taken on the eve of the conclusion of the Uruguay Round provided for the review of Art. 17.6 of the ADA “with a view to considering the question of whether it is capable of general application”. Apparently, such a review failed to yield any result. This further underscores the importance of Art. 17.6.

Under Art. 17.6 (i), the panel will accept the findings of facts by the national authority, provided the establishment of the facts was proper and the evaluation of the facts was unbiased and objective. Similarly, the panel will accept the interpretation of legal provisions by the national authorities provided such an interpretation is permissible as per the customary rules of interpretation. In either of the cases, national determinations will be accepted, even if the panel would have reached different conclusions on questions of fact or law. Though this distinct standard is confined to the ADA, in practice, the panels have extended the same approach to Part V of the Agreement on Subsidies and Countervailing Measures.17

The reason for this distinct standard of review is that the ADA itself has laid down elaborate rules which have to be complied with by the administering

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authorities; judicial review would ensure this compliance. It may be noted that there are quite a few other MTAs which lay down elaborate procedure to be followed by administrative authorities, such as the Agreement on Customs Evaluation, Technical Barriers to Trade, but these agreements do not contain the provisions analogous to Art. 17.6 of the ADA. One plausible reason could be the absence of judicial review under these Agreements. On the other hand, the presence of judicial review in the Agreement on countervailing measures could have been the reason for the panels to follow the special standards of review in those cases.

VIII. Conclusion

Evolution of international anti-dumping law has been by way of introducing more and more conceptual clarity and procedural safeguards with a view to preventing the abuses thereof. The GATT, 1947 laid down only the basic rules and the Kennedy Round and Tokyo Round Codes clarified the concepts such as material injury, causal link etc. and elaborated procedural safeguards to be followed by the domestic authorities in charge of anti-dumping administration. The WTO contains the comprehensive anti-dumping code. In the absence of adequate domestic legal safeguards, national courts could not have played any kind of significant role prior to the WTO Agreement, and the WTO for the first time provided for the judicial review of anti-dumping administration.

Art. 17.4 of the ADA literally carried forward Art. 15.3 of the Tokyo Round Code. Apparently the significance of Art. 13, providing for judicial review, was not adequately appreciated while drafting Art. 17.4. However, a contextual interpretation in light of the purpose and object concerned requires that the home state of the exporter ensure that available judicial remedies must be exhausted before resorting to the WTO dispute settlement mechanism. “Final action” under Art. 17.4 requires the approval of the “final determination” by the judiciary under Art. 13. This interpretation is consistent with the principles of Public International Law.
TRIPS through the lens of Global Public Goods: Are TRIPS-plus FTAs eating up all the good there is?

Ishupal Kang

Abstract

With the adoption of TRIPS Agreement in 1994 emerged an unprecedented international legal regime of global IP protection. Much has been talked about the fairness of this regime and almost all of such discussions conclude that the TRIPS agreement leans in the favour of the developed nations. Still, it is argued that TRIPS can be viewed as possessing certain features which make the regime set up by TRIPS being identified as a Global Public Good (GPG). The article outlines the peril faced by this GPG, in the form of the recent practice of the developed nations to negotiate higher levels of IP protection in the guise of bilateral free trade agreements known as TRIPS-Plus FTAs. Though these FTAs are compliant to the TRIPS and other WTO norms, they tend to make the common minimum standards of TRIPS irrelevant. These FTAs not only worsens the already skewed global IP protection framework but also hampers the availability of other public goods such as elimination of epidemic diseases, improvement in human health and well being which are of far much importance than the unbalanced global IP scenario. The article concludes by offering plausible solutions which could be pursued to deal with this complex issue.

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I. INTRODUCTION

The TRIPS Agreement (TRIPS) was adopted in 1994, as part of a bundle of multilateral agreements ushering a new global trading regime called the World Trade Organization. Since its adoption, TRIPS has had a bitter history and has sparked plenty of controversy.1 It has predominantly been accused of being tailored to the needs of developed and industrialized nations, though it does contain certain provisions which seem to accord developing and poorer countries some room to adjust their Intellectual Property (IP) norms in conformity with the interests of their people. In brief, the distinguishing feature of TRIPS is that it establishes minimum standards of IP protection and hence creates a never-seen-before harmonization of norms and standards relating to IP protection worldwide. Latching onto this thread, this essay analyses TRIPS through the Global Public Goods perspective and considers whether TRIPS itself can be seen as a Global Public Good (GPG) and, consequently, what the impact of the current flurry of TRIPS-plus FTAs on the proper and efficient utilization of this GPG is, especially by developing countries.

II. IS TRIPS ANY GOOD AT ALL?: TRIPS AS A GLOBAL PUBLIC GOOD

A. Global Public Good Approach: A brief outline

In simple terms, a public good is one which has the twin properties of being non-excludable, i.e., nobody can be excluded from its use, as well as non-rival, i.e. the availability of the good is not diminished after consumption.

Public goods can be best understood in comparison to private goods: clean air, often cited and much clichéd, is an example of a pure public good, while a commodity like a burger is essentially a private good. The GPG approach, which is a recent offshoot of the traditional public good theory, is concerned with the transnational spill-over effects of some public goods: elimination of epidemic diseases, environmental sustainability and promotion of free trade, to name but a few, are now seen as GPGs, as their availability considerably impacts the well being of all mankind. The GPG approach has emerged as an important perspective to look at the phenomenon of globalization and the trends and processes that come with it.3

Non-excludability and non-rivalry, however, are not intrinsic attributes of goods, but are often the result of societal choices to make goods available in that manner. In light of this, Kaul and Mendoza4 propose a wider definition centred around the idea of being ‘de facto public in consumption.’5 For instance, roads - a typical illustration of a public good - can, as an infrastructure, support different uses, which may be deemed more or less beneficial to society as a whole (think of a road used by tractors for farming, as opposed to one leading to an elite holiday resort and used chiefly by polluting SUVs). Depending on what uses that infrastructure can be put to, it may (or may not) be kept non-rival and non-excludable.

A similar approach can be taken vis-à-vis GPGs: demand for a GPG may vary depending on the particular international situation. TRIPS itself, for example, has emerged only when the need was felt, owing to increasing globalization, to establish uniform protection of intellectual property.

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3 See Inge Kaul et al., Why Do Global Public Goods Matter Today?, in, PROVIDING GLOBAL PUBLIC GOODS: MANAGING GLOBALIZATION at 1, 1-5 (Inge Kaul et al. eds., 2003) [Hereinafter PROVIDING GPGs].

4 See Inge Kaul and Ronald U. Mendoza, Advancing the Concept of Public Goods ?, in, PROVIDING GPGs, supra note 3, at 78, 80-81.

5 Id.
Hence, according to Morrissey, the best way to define a GPG is as a utility, bestowing some kind of benefit which is, in principle, available to everyone across the globe.\(^6\)

**B. TRIPS as a Global Public Good**

To establish the basic premise of this essay, we have to place TRIPS among the class of GPGs. For this purpose, TRIPS will first be analysed as an international legal regime and, afterwards, the concerns will be addressed about the benefits of the legal regime established by TRIPS.

(i) **International Legal Regimes as GPGs: TRIPS included**

Exponential rise in interaction and interdependence among states has led to the necessity of formulating some commonly accepted norms, rules and standards, with the aim of enhancing cooperation and reducing conflicts. International legal regimes which establish these global standards are usually considered to have a ‘crucial public good component’.\(^7\)

From this point of view, TRIPS, by establishing minimum standards on IP protection, and also as part of a wider multilateral trade regime, displays such properties which indicate it being a GPG.\(^8\) First of all, it creates the widest international intellectual property regime owing to its extensive membership, which includes all the WTO members, making it truly multilateral and global in nature. The non-excludability feature is a corollary following this wide membership, in the sense that once a nation joins TRIPS, it cannot, in principle, be excluded from the benefits of the global IP regime under it. Again, it is also non-rival in consumption, implying that participation of any new members does not lead to a reduction in the benefits available to existing ones.\(^9\)

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\(^8\) See Kaul and Mendoza, *supra* note 4, at 98.

(ii) Is TRIPS a global benefit in real sense?

While analysing TRIPS vis-à-vis the GPG approach, neither the question of non-excludability nor that of non-rivalry is as contentious as the question of whether TRIPS is, indeed, a public good (i.e. whether it generates some kind of utility), especially for poorer countries. TRIPS reflects the bitter conflict between the interests of the developed and developing countries and the persistent efforts of the former to maintain their dominance over the latter, which are perceived as nothing more than markets for selling products.\(^{10}\)

Further, there hardly appears to be much substantial correlation between greater IPR protection and potential benefits, like increased FDI, technology transfer, and so on.\(^{11}\)

Theoretically, the benefits arising out of a GPG must be completely global, in practice it is not so.\(^{12}\) Public benefit does not imply that every member of the relevant public actually derives a ‘measurable benefit’, or the same level of utility.\(^{13}\) Hence, the guiding principle here is that benefits should theoretically be available to all, even if some users do not benefit as much as others. Supporting the idea that TRIPS makes benefits available to all its members, one can refer to pro-South provisions of the Agreement, like Arts 7 and 8, dealing with object and principles, which, in the words of Yu, ‘may provide less-developed countries with important tools for restoring the balance of the international intellectual property system’,\(^{14}\) along with several other flexible provisions\(^{15}\) such as those on compulsory licensing,\(^{16}\) parallel

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12 See Morrissey supra note 6, at 34.

13 See Morrissey supra note 6, at 34.

14 See Peter K. Yu, supra note 1, at 982.


importation, experimental use exception and developments like the Doha Declaration on the TRIPS Agreement and Public Health. Moreover, some scholars, like Reichman, are of the view that ‘the medium and long term effects of the IP regime set up by TRIPS may ‘boomerang’ against the developed countries leading to a more equitable position for developing countries’.

III. TRIPS-plus FTAs

Recently, it has become more common for developed countries, most prominently the U.S., to enter into Free Trade Agreements (FTAs) with developing countries, which contain IP protection that is more stringent than the minimum standards prescribed in the TRIPS Agreement, thus known as TRIPS-plus FTAs. This has emerged as an important tool for developed countries in the wake of stronger resistance put forward collectively by developing countries in the multilateral set-up. In this sense, the TRIPS agreement becomes a ‘floor rather than the ceiling’ as far as global IP norms and standards are concerned. But these TRIPS-plus FTAs do not only raise the level of IP protection, but also restrict the use of TRIPS’ flexibilities.

A. TRIPS-Plus FTAs: A closer look

Concerns of public health, due to the higher patent protection, are the most pressing in the TRIPS-plus FTAs debate. As an illustration, FTAs concluded by the U.S with developing countries like Chile, South African

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17 Ibid., Art. 8.1.
18 Supra note 16, Art. 30.
21 Collins-Chase, supra note 11, at 780.
and Central American States contain TRIPS-plus provisions, like extended protection by longer patent terms, a wider range of patentable subject matter and, most importantly, limitations on TRIPS flexibilities like those on compulsory licensing and parallel importation. These flexibilities in the TRIPS Agreement are crucial from the developing nations’ perspective, most remarkably those battling with epidemic diseases such as HIV/AIDS and facing the problem of access to life-saving drugs. Narrowing policy options in these areas leave such nations with hardly any choice or strategy to combat similar threats to human health. The negative impact of such FTAs can even be seen in countries like Australia and Jordan, who have TRIPS-Plus FTAs with the U.S., resulting in a two-year delay in release of generic versions of patented drugs, rise in drug prices and harm to local production.

B. Impact on TRIPS

Considering sovereign states act in the international arena as private actors, always following policies which are conducive and in consonance with their national interests, the impact of such an approach is definitely a matter of concern. As there is no central agency to govern and supervise the conduct of sovereign states, keeping the interests of all in perspective, there is always the need for a minimum standard of international cooperation to arrive at some common ground. Though some may debate it, TRIPS can be viewed as such a common ground. Raising the level of IP protection through these FTAs disrupts whatever little balance we can make out of TRIPS. The main purpose of TRIPS may be to establish minimum standards of IP protection, but the provisions like the flexibilities are an integral part of it, giving space to nations to exercise their autonomy by moulding IP protection to suit their specific needs.

Moreover, the problem is not just limited to disequilibrium caused in respect to the legal utility and benefits of the TRIPS Agreement, it is deeper

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25 See Collins-Chase, supra note 11, at 780.
26 See Kaul, GPGs in Multi Actor World, supra note 2, at 7.
and much more sinister. TRIPS-plus FTAs restrict the availability of other public goods like reduction of epidemic diseases and overall improvement in human health, which are much more essential than protection of intellectual capital. In this sense, as Chon puts, TRIPS can be seen as a global intermediary good which leads to provision of several public goods.27

IV. TACKLING THE TRIPS-PLUS PROBLEM

The solution to the problem posed by TRIPS-plus FTAs is not straightforward. Objectively speaking, these FTAs are WTO-compliant, as even the TRIPS Agreement provides that enhanced levels of IP protection may be negotiated and enforced between the member nations.28 Moreover, the weak bargaining position of developing countries, in a bilateral setting, which is a strong incentive for developed countries to resort to TRIPS-plus FTAs, makes the prospect of renegotiations or other such efforts improbable.

In such a situation, analyzing the problem from a GPG approach seems to offer some plausible solutions. The approach offers a wider perspective which is not limited to TRIPS as a tool for establishing a global IP regime. Instead, it helps us to view the regime set up by TRIPS in relation to other key policy concerns. Accordingly, the TRIPS-plus obligations which are being thrust upon developing countries through FTAs can be seen as “public bads” which, apart from affecting the functioning of TRIPS, are also becoming big obstacles in the ability of several countries to provide for other more important public goods such as control of epidemic diseases and a high level of public health.

The strategy to be adopted to combat this issue is twofold. In the short term, the focus should be on addressing those issues which are more pressing, rather than on restoring the balance of the global IP regime. Accordingly, problems like the access to essential medicines are to be seen independently


28 TRIPS, supra note 16, Art. 1.
from the TRIPS-plus debate. It must be understood that such problems can be best tackled if efforts are made in alternative fora of international cooperation which are much more suited and are sympathetic towards such concerns, like specialized agencies of the United Nations such as WHO and other civil society groups.

On other hand, the ambitious goal of achieving an equitable stand in the global IP regime can be best pursued through collective efforts in the multilateral set up. This suggestion seems easier said than done. However, keeping in mind the recent developments such as the Doha Declaration\(^\text{29}\) and the 2005 TRIPS Amendment,\(^\text{30}\) there is some room for hope.


Article 102 and High Technology Industries: The Impact of the European Microsoft and Intel Cases

Michael Reynolds and Michelle Chowdhury

Abstract

High technology industries have frequently come under scrutiny by competition authorities, and the computer software and hardware industries are no exception. In the last few years the European Commission (the Commission) has imposed record fines on two of the world’s largest high technology companies, the Microsoft Corporation (Microsoft) and the Intel Corporation (Intel), for abuse of their respective dominant positions under Article 82 of the EC Treaty (now Article 102 of the Treaty on the Functioning of the European Union (Article 102)). Two separate cases have been brought against Microsoft, one of which started in 1998 and is still ongoing. The Intel case has also taken almost a decade so far, and has yet to reach its final conclusion.

This article gives an overview of these cases, all three of which are substantively and procedurally complex. The article concludes with some reflections on the impact of these cases on the development of antitrust law and the consequences for future defendants.

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2 As a result of the Lisbon Treaty there has been a wholesale renumbering of the Articles of the EC Treaty, including of what were previously known as Articles 81 and 82 – renumbered now to Articles 101 and 102. There has been no substantive change, as the original wording has been retained. The Microsoft and Intel cases were originally brought under Article 82, but for clarity the new numbering will be used in this article.
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I. MICROSOFT v. COMMISSION

The Commission has brought two major cases against Microsoft for infringement of Article 102, the first concerning work group servers and Windows Media Player (WMP) – the Sun Microsystems case\(^3\) - and the second relating to Internet Explorer (IE) and file formats – the Opera case.\(^4\)

A. Sun Microsystems – the Work group server and WMP case

(i) Background

Microsoft is active in the supply of a range of software products including and in particular, operating systems. An operating system is a software product that controls the basic functions of a computer and allows the user to run a variety of applications. Microsoft supplies operating systems for client PCs (i.e. individual computers, which may or may not be connected to a network), as well as for work group servers (i.e. operating systems for small- to medium-sized networks of computers that allow delivery of basic network services – sharing of files stored on servers, sharing printers, and administration of network access). In order for a work group server to function, its operating system must be compatible with the operating system of the client PCs connected to the network, as well as with the operating systems of any other networks with which the work group server is integrated.

On 10 December 1998 Sun Microsystems Inc. lodged a complaint against

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\(^3\) Case COMP/ 37.792.

\(^4\) Case COMP/39.9530.
Microsoft with the Commission, alleging that Microsoft was acting in breach of Article 102. Sun Microsystems was also active in the supply of work group server operating systems. Sun Microsystems complained that Microsoft was refusing to disclose to it the technology necessary to allow interoperability of Sun Microsystems’ work group server operating system with the Windows client PC operating system, supplied by Microsoft. Sun Microsystems claimed that without this interoperability information it would be unable to compete on the market for work group server operating systems.

In addition, in February 2000 the Commission launched an investigation into Microsoft’s WMP product. WMP is one of several software products capable of reading sound and image content in digital format “streamed” over the internet, i.e. it can decode the corresponding data and translate them into instructions for hardware (for example, loudspeakers or a screen). The Commission’s concerns centred on the integration by Microsoft of WMP into its Windows operating system.

The Commission sent Microsoft three Statements of Objections (SOs) in which it set out its preliminary view of the case. The First SO, sent on 2 August 2000, raised concerns in relation to interoperability between the Windows client PC operating system and third party work group server operating systems (“client-to-server interoperability”). The Second SO, sent on 29 August 2001, expanded the objections of the First SO to include issues of interoperability between third party work group servers and Microsoft’s work group servers (“server-to-server interoperability”). The Commission also addressed the concerns relating to WMP. The Third SO, issued on 6 August 2003, further supplemented the first two.

More than five years after the initial complaint had been lodged, the Commission adopted a decision on 24 March 2004 (the Infringement

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5 IP/00/141, Commission examines the impact of Windows 2000 on competition.
6 IP/00/906, Commission opens proceedings against Microsoft’s alleged discriminatory licensing and refusals to supply software information.
7 IP/01/1232, Commission initiates additional proceedings against Microsoft.
8 IP/03/1150, Commission gives Microsoft last opportunity to comment before concluding its antitrust probe.
Decision) finding that Microsoft had infringed Article 102 EC.  

(ii) The Infringement Decision

The Commission found that there were three distinct product markets in issue:

- **Market 1.** Client PC operating systems
- **Market 2.** Work group server operating systems
- **Market 3.** Streaming media players

In relation to the client PC operating system market (Market 1) the Commission found that, at least since 1996, Microsoft had held a dominant position with a market share of over 90%. This dominant position had been protected by significant barriers to entry attributable to indirect network effects. These indirect network effects were caused by two factors: (i) end customers appreciate platforms on which they can use a large number of applications, and (ii) software developers design applications for the PC operating systems that are most popular with customers.

The Commission identified two ways in which Microsoft was leveraging its dominance in Market 1, with the conduct having effects in Markets 2 and 3 respectively:

**Refusal to supply** – Microsoft was found to have abused its dominant position in Market 1 by refusing to supply Sun Microsystems and other suppliers of server operating systems with the interoperability information needed by these firms in order to compete effectively against Microsoft’s work group server operating systems in Market 2. The interoperability information was so vital that Microsoft’s refusal risked eliminating competition in Market 2. The Commission found Microsoft to have both short run and long run incentives to foreclose rivals from the work group server market, and this contention was supported by documentary evidence in the form of internal communications within Microsoft. The abusive conduct was found to have taken place from October 1998 to the date of the Infringement Decision and was part of a general pattern of conduct that involved a disruption to previous levels of supply of information with a negative effect on technical development. The Commission rejected
Microsoft’s arguments that there was an objective justification for its refusal.

**Tying** – Microsoft was found to have abused its dominant position in Market 1 by tying WMP with its Windows client PC operating system, such that no version of the Windows client PC operating system was available without WMP. The Commission found that since this mode of distribution to PC users was only available to Microsoft, and was by far the most effective means of distribution, it would allow Microsoft to weaken competition in Market 3. Microsoft’s conduct satisfied the four conditions for tying, for the purposes of Article 102 EC:

(i) Microsoft has dominance in the market for the “tying good” (i.e. client PC operating systems),

(ii) The tying good and “tied good” (i.e. streaming media players) are separate products,

(iii) No untied supply is available (it was not possible to get a Windows client PC operating system without WMP), and

(iv) The tying forecloses competition in the market for streaming media players.

The abusive conduct was found to have taken place from May 1999 until the date of the Infringement Decision.

**(iii) Remedies**

Microsoft was fined almost €500 million (US$600 million) and ordered to remedy the abusive conduct. To address its refusal to supply abuse, Microsoft would be required to disclose to its competitors specifications of protocols used by Windows work group servers on reasonable terms by 27 July 2004. The Infringement Decision also provided for the appointment of a monitoring trustee, nominated by Microsoft, to provide impartial expert advice to the Commission on compliance issues. The trustee was empowered to access Microsoft’s documents, premises, employees and source code and to monitor implementation of the remedies. Microsoft was made liable for the costs of the trustee.

To address the tying abuse Microsoft was ordered to offer a version of its
Windows operating system that did not include the WMP by 28 June 2004, and to refrain from using technological, commercial or contractual means that would be equivalent to tying in the future.

(iv) Appeals and non-compliance

Following the initial Infringement Decision in March 2004, Microsoft lodged an appeal (the Main Appeal) with the Court of First Instance (the CFI) on 7 June 2004.10 Later that month Microsoft announced that it had also filed for interim measures (the Interim Request), requesting that the CFI suspend the remedies ordered by the Commission until the outcome of the Main Appeal, so as to delay the disclosure of information and the release of an unbundled version of Windows until the CFI had ruled on the Infringement Decision.11

The Interim Request was dismissed on 22 December 2004.12 The following year, in November 2005, the Commission took a decision under Article 24(1) of Regulation 1/2003 finding that Microsoft had not complied with the March 2004 Infringement Decision.13 The Commission issued an SO relating to this alleged continuing non-compliance and, after receiving Microsoft’s responses, imposed a penalty of €280.5 million (US$350 million) on Microsoft on 12 July 2006 (the First Compliance Decision).14 On the same date, the Commission decided that, should Microsoft continue to fail to comply, the maximum amount of the penalty would be increased from €2 million per day to €3 million per day with effect from 31 July 2006.

The Main Appeal was not heard until April 2006 when a five-day hearing took place before the CFI. On 17 September 2007, almost a year and a half later, the CFI handed down its judgment upholding the Commission’s

12 Order dated 22 December 2004 in Case T-201/04 R.
Infringement Decision. The only modification related to the monitoring trustee. The CFI ruled that the Commission did not have the power to oblige Microsoft to appoint and pay for a trustee empowered to retrieve various prescribed information from Microsoft.

In relation to the refusal to supply interoperability information, the CFI confirmed that a refusal by a dominant firm to license intellectual property does not itself constitute an “abuse” under Article 102. Such conduct may be an abuse if the product or service is indispensable to competing in a different market, but even then, only if the refusal would exclude competition on the neighbouring market, and if the refusal prevents the appearance of new products for which there is potential consumer demand. The CFI ruled that these exceptional circumstances were present in the case of Microsoft, and that there was no objective justification for its conduct.

In relation to the WMP tying abuse, the CFI used a weaker legal test than had been previously applied, stating that it was only necessary to examine whether the tying by its nature had a foreclosure effect, and not necessary to look at the actual effects the bundling had already had on the market. The CFI therefore significantly widened the scope of the tying abuse.

The following month, Microsoft made commitments to comply with the Infringement Decision and withdrew the remaining appeals it had lodged with the CFI, firstly against the First Compliance Decision (the First Compliance Appeal), and secondly against aspects of the remedies imposed by the Infringement Decision.

On 27 February 2008 the Commission took a further decision against Microsoft on compliance (the Second Compliance Decision). The Commission fined Microsoft €899 million (US$1.1 billion) for non-compliance. The Commission found that, contrary to the Infringement Decision, Microsoft had not provided other work group server suppliers with complete and accurate technical information on reasonable terms to allow

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16 Order dated 27 November 2007 in Case T-313/05 and Order dated 6 December 2007 in Case T-271/06.
them to compete. In particular, Microsoft was attempting to charge excessive royalties for protocols which it claimed were innovative but which the Commission found were not. The fine related to non-compliance for the period between June 2006 and October 2007, the earlier period having already been covered by the First Compliance Decision.

On 9 May 2008 Microsoft lodged an appeal against the Second Compliance Decision (the Second Compliance Appeal).\(^{18}\) The grounds for appeal were as follows:

- The Commission imposed the penalty payments in order to force Microsoft to apply “reasonable” price terms without first specifying what terms the Commission would consider to be reasonable. Microsoft was therefore unable to avoid the penalty.
- The Commission made a manifest error of assessment and breached its duty to state reasons.
- The Commission did not give weight to the fact that (i) Microsoft’s published rates were lower than those which a third party determined were reasonable, and (ii) no prospective licensee had failed to reach an agreement.
- The Commission based its assessment on reports of the monitoring trustee which in turn were based on documents obtained using investigatory powers which the CFI had held to be unlawful.
- The €899 million fine was excessive and disproportionate.

In November 2008 the CFI granted leave to intervene to Computing Technology Industry Association Inc (CompTIA) and the Association for Competitive Technology, Inc (ACT) on behalf of Microsoft; and to the Software and Information Industry Association (SIAA), Free Software Foundation Europe (FSFE), Samba Team, Red Hat, Inc. and the European

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\(^{18}\) OJ C 171 of 05.07.2008 at 41.

\(^{19}\) Order dated 20 November 2008 in Case T-167/08.
Committee for Interoperable Systems (ECIS) – which groups together companies including Adobe, IBM, Nokia and Oracle – on behalf of the Commission. As of May 2010 no further progress had been made on the Second Compliance Appeal. We will have to wait and see how this case pans out before we fully understand the CFI’s position in relation to the Commission’s power to impose remedies.

B. Opera – the File formats and IE case

(i) Background

Like the Sun Microsystems case, the Opera case also consists of two strands – an alleged refusal to supply abuse and an alleged bundling abuse.

Opera, a Norwegian internet browser company, filed a complaint with the Commission on 13 December 2007 in relation to web coding standards and the bundling of Internet Explorer (IE) into the Windows client PC operating system. The Commission sent Microsoft an SO on 15 January 2009. The SO followed the precedent set in the previous Infringement Decision and the CFI judgment.

In April 2009 the Commission granted “interested third party” status to ECIS. ECIS alleged that Microsoft was refusing to disclose sufficient interoperability information across a range of products, including information relating to its Office suite, a number of its server products, and also in relation to the so-called .NET Framework. In addition ECIS claimed that Microsoft’s new file format (Open Office XML), as used in Microsoft Office, was not sufficiently interoperable with competitors’ products.

Google, Mozilla, FSFE and PIN-SME joined ECIS in intervening in the case on behalf of the Commission. The Association for Competitive Technology (ACT) intervened on behalf of Microsoft.

20 MEMO/09/15, Commission confirms sending a Statement of Objections to Microsoft on the tying of Internet Explorer to Windows.
(ii) Commitments

The initial prospects did not look good for Microsoft. Commentators speculated that the fine that might be imposed by the Commission could well exceed the record fine levied against Intel in 2009. The Commission stated that the start date of the infringement, if one was found, would be 1996 and the end date would be beyond the 2004 Infringement Decision. This would have led to a large multiplier, which could also have meant that the fine would have hit the statutory ceiling of 10% of global revenues, i.e. over $5 billion.

A closed-door hearing was initially proposed for 3 to 5 June 2009 but Microsoft objected to the dates because an international conference of antitrust officials was to be held over the same dates and the scheduling clash would mean that key decision-makers might be absent from the hearing. The hearing officer deemed Microsoft to have withdrawn its request for an oral hearing and the hearing was not rescheduled.

The remedies in the first Microsoft case were widely criticised as ineffective. In particular, sales of the version of the Windows operating system supplied without WMP were very low. The Commission’s concerns in relation to IE mirror those in the WMP case – i.e. that Microsoft has unique access to a distribution system making IE available to 90% of PC users, and that this also encourages software developers to design their products so as to be Windows and IE compatible. Therefore when, in June 2009, Microsoft announced that it would be launching a new Windows operating system without IE, the Commission expressed concern that this proposal would actually offer consumers less, rather than more, choice and would therefore not be an effective remedy.\textsuperscript{22}

In July 2009 it was reported that Microsoft had proposed substantial

\textsuperscript{22} MEMO/09/272, Commission Statement on Microsoft Internet Explorer Announcement.

\textsuperscript{23} MEMO/09/352, Commission welcomes new Microsoft proposals on Microsoft Internet Explorer and Interoperability, \url{http://ec.europa.eu/competition/antitrust/cases/decisions/39530/commitments.pdf}.

remedies to deal with these concerns. Amongst the five-year commitments market tested by the Commission in October 2009, Microsoft offered to supply a version of Windows which would enable original equipment manufacturers (OEMs) or consumers to suppress IE. The deadline for comments on Microsoft’s commitments was 9 November 2009. On 16 December 2009 the Commission announced that it had adopted a Commitment Decision under Article 9 Regulation 1/2003 accepting Microsoft’s commitments and making them legally binding.

Under the commitments, Microsoft has agreed to make available for five years in the European Economic Area a “Choice Screen” enabling users of Windows XP, Windows Vista and Windows 7 to choose which web browsers they want to install in addition to, or instead of, IE. This facility will be available through the Windows automatic update mechanism. The commitments also provide that OEMs will be able to install competing web browsers, set those to default and turn off IE.

If Microsoft were to break its legally binding commitments it would be subject to a fine imposed by the Commission of up to a maximum of 10% of Microsoft’s annual turnover. The Commission would not have to prove breach of EU competition rules.

The commitments are to be reviewed by the Commission in two years’ time. This review will confirm whether the commitments made by Microsoft have been sufficient to allay the Commission’s concerns, and will therefore be followed very closely by other players in high technology industries.

II. INTEL V. COMMISSION

A. Background

In October 2000 Advanced Micro Devices, Inc. (AMD) filed a complaint
with the Commission against Intel for offering allegedly abusive rebates and imposing exclusivity provisions in relation to x86 Central Processing Units (CPUs) – the computer chips that make up the main hardware component of a computer. Five years later, the Commission and national competition authorities raided Intel’s offices across Europe. In 2006 AMD and the Federation of German Consumer Organisations (Verbraucherzentrale Bundesverband, VZBV) filed complaints with the German competition authority (Bundeskartellamt), which were subsequently passed to the Commission. The Commission sent Intel an SO in July 2007, and raided Intel’s premises again in February 2008. After an oral hearing in March 2008, a second SO was sent to Intel in July 2008.

B. The Decision

In May 2009 the Commission imposed a record fine on Intel of €1.06 billion (US$1.3 billion), or 4.15% of Intel’s worldwide turnover in 2008, for abuse of its dominant position; the largest fine ever levied on one firm. The abuse was found to have taken place between 2002 and 2007, during which Intel held at least 70% of the market for x86 CPUs.

Applying its new guidelines on exclusionary abuses, the Commission found that Intel had foreclosed the market by:

1. **Offering illegal royalty rebates**

Intel offered significant rebates, which were wholly or partially hidden, to OEMs that bought all or substantially all of their x86 CPU requirements from Intel. Intel also made direct payments to a major retailer on the condition that it stocked only computers with Intel x86 CPUs. It is important to note that the Commission did not hold that rebates are illegal

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28 MEMO/07/314, Commission confirms sending Statement of Objections to Intel.
29 MEMO/08/517, Commission confirms supplementary Statement of Objections sent to Intel.
30 MEMO/09/235 Commission imposes fine of 1.06 billion Euros on Intel for abuse of dominant position; orders Intel to cease illegal practices - questions and answers.
in themselves; the Commission accepts that rebates are an inherent part of doing business and can be beneficial to the consumer. The Commission did however find that the conditions attached to the rebates/payments offered by Intel excluded AMD from the market, impeded innovation and prevented customers (and ultimately consumers) from choosing rival products.

2. **Payments to manufacturers**

Intel also made payments to OEMs which were unrelated to the purchase of Intel products, to delay or cancel the launch of AMD-based products and/or to put restrictions on the distribution of specific AMD-based products. The Commission concluded that these payments had the effect of preventing competing products, for which there was a consumer demand, from being introduced to the market.

Intel lodged its appeal against the fine in July 2009, claiming that the Commission committed several legal errors.\(^{33}\) Intel claimed that the Commission misinterpreted and ignored certain evidence when constructing its case, and failed to meet the required standard of proof. In particular, Intel believes that the Commission failed to conduct any analysis of the foreclosure effects of the rebates in Europe, and also incorrectly applied the “as efficient competitor” test which formed part of its analysis.

In November 2009 the EU Ombudsman, a watchdog that monitors EU institutions, criticised the Commission’s handling of the case, in particular the failure of the Commission in taking a proper note of the meeting with the computer-maker Dell, which formed part of its investigation.\(^{34}\) The Commission has however stood–by its interview procedure in the face of the Ombudsman’s criticism, claiming that informal interviews, such as those that occurred with Dell, were valuable as part of the investigative procedure. It is worth noting, however, the Ombudsman did not find that the Commission had infringed Intel’s rights of defence.

\(^{33}\) OJ C 301 of 22.11.2008 at 60.

III. Conclusions

Although the cases discussed above are still in progress, it is not too early to reflect on their impact, not least because more than a decade has passed since the first Microsoft case was launched. This in itself demonstrates a key problem with antitrust enforcement in high technology industries – by the time the cases have reached their conclusion the marketplace has moved quickly beyond the problems dealt with in the case, and some of the competitors involved may have fallen by the wayside in the meantime.

Further, the fate of Microsoft, subject to a second investigation just as the first was finally drawing to a close, should be noted by other companies as an indication that allowing the relationship with the Commission to sour may lead to a string of antitrust cases. The support the Commission had from the CFI in the Microsoft case will also be useful to the Commission as a bargaining tool against any future infringers contemplating bringing an appeal against a Commission decision.

The above cases clearly demonstrated a movement towards large fines for antitrust breaches – Microsoft’s fine of almost €500 million (US$600 million) under the Infringement Decision was the highest fine ever to be imposed on an individual company as of 2004, a dubious title now held by Intel. The revised fining guidelines35 give the Commission the power to impose very large fines and it has not shied away from using such power. The Commission has made clear that it wants to send a strong message that it takes abuse of dominance seriously and this area of antitrust law is a key enforcement priority. The Commission is trying to reinforce its position as a progressive and activist enforcer, something that has not changed with the rotation of power within the Commission towards the end of 2009.

There has been much criticism of the mounting levels of fines imposed by the Commission, in Article 102 cases and also in cartel cases. Some

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35 Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003 (2006/C 210/02).

36 See e.g., D. Slater et al., , Competition law proceedings before the European Commission and the right to a fair trial: no need for reform?, GLOBAL COMPETITION LAW CENTRE WORKING PAPERS SERIES, GCLC WORKING PAPER 04/08, http://www.coleurope.eu/content/gclc/documents/GCLC%20WP%2004-08.pdf.
perspective is of course needed – the €500 million (US$600 million) fine imposed on Microsoft in the Sun Microsystems case can be compared to the €50 billion of cash on Microsoft’s balance sheet at the time of the decision. However, the growth in the fine amounts imposed by the Commission over the last few years has been almost exponential. Some have argued that such penalties are contrary to the principles of due process. The argument goes that the fines have been so high that they can now be deemed criminal in nature. If that is the case then the concern is that the administrative procedures that make up an antitrust investigation would not meet the standards of a criminal investigation. Further, the dual role of the Commission as investigator and adjudicator becomes even more perverse, and may even violate Article 6(1) of the European Convention on Human Rights (the ECHR).37

There are naturally two sides to this story. The other side concerns adequate punishment of offenders, successful deterrence through administrative penalties, and some concept of proportionality that takes into account the level of damage caused by competition law infringements. From this point of view the Commission’s latest spate of penalties have not been “too high”, rather the fines levied in the preceding decades have been “too low”. The legal basis of the fines has not changed and the fines are no more criminal than they ever were. It is still relatively rare for the Commission’s fine to reach the 10% turnover cap, the express purpose of which is to limit the penalties to a proportionate amount. Finally, the Community courts

40 See e.g. Joined Cases C189/02 Dansk Rørindustri A/S and others v Commission, [2005] ECR I-5425, ¶ 281: “That [10%] limit is therefore one which is uniformly applicable to all undertakings and arrived at according to the size of each of them and seeks to ensure that the fines are not excessive or disproportionate.”
41 See e.g. the recent judgment in Case T54/03 Lafarge v Commission, ¶ 35 (not yet published); also see Joined Cases 209/78 et al. Heintz van Landewyck and others v Commission, [1980] ECR 3125, ¶ 81.
have repeatedly ruled that the Commission is not a “tribunal” under Community law and therefore its dual role does not violate the ECHR.41

Putting aside the remarkable fines, the Intel and Microsoft cases also raised issues of the nature of the Commission’s investigation. The Intel case in particular gives an example of the extensive powers of investigation that the Commission is prepared to use in abuse of dominance cases. The Commission highlighted that Intel went to great lengths to conceal the existence of the anti-competitive conditions attached to its rebates and payments, ensuring that they were not evident on the face of the agreements. However, the Commission relied on emails and other contemporaneous evidence, gathered from the dawn raids of Intel’s offices and through responses to information requests, to establish the illegal conditions.

Microsoft argued that the proposed disclosure remedies in the work group server and WMP case would limit its incentives to innovate. It may turn out however that the increase in interoperability actually enhances Microsoft’s incentives to innovate, as it tries to ensure that its work group servers are better than the competition. If this increase in innovation manifests itself then it may have an impact on remedies in future high technology cases.

In other respects the Microsoft case does have some unique features, i.e. Microsoft’s “super-dominance”, which may prove a distinguishing factor in terms of the cases’ substantive precedential value. However, the CFI’s judgment in the work group server and WMP case may prove to have significantly lowered the threshold for an obligation to license IP rights as well as having widened the scope of abusive tying. The CFI was at pains to point out the “special responsibility” to the market which dominant undertakings have. Whatever the distinguishing features, the Intel and Microsoft cases will clearly be used as a guide and a benchmark for Article 102 cases in high technology industries in the future.