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Interpreting Investment Treaties in Good Faith: Whose Good Faith?

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It is not unnoticed that good faith gained relevance in investment treaty arbitration. There is an increasing number of decisions where good faith was relied on by tribunals on the basis of Article 31(1) of the Vienna Convention on the Law of Treaties ("VCLT"), the general rule of interpretation, according to which "[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".

Recent decisions show, however, that arbitrators tend to misunderstand whose good faith Article 31(1) of the VCLT is referring to. Whilst Article 31(1) of the VCLT places a duty of good faith on the interpreter, certain tribunals considered that the reference to good faith in the general rule of interpretation meant the duty of States to act in good faith. This was the case of certain decisions brought against Russia under the Russia-Ukraine BIT of 27 November 1998, where tribunals decided, as a matter of treaty interpretation, that it was contrary to good faith for Russia to deny investment treaty protection to Ukrainian investments in Crimea at the same time that Russia declared the annexation of the region into its territory.

The Crimean Cases

After Russia took control of Crimea in 2014, a number of Ukrainian nationals started arbitral proceedings against Russia under the Russia-Ukraine BIT, seeking compensation for alleged losses incurred in relation to investments made in the region. As previously reported on Kluwer Arbitration Blog, Russia challenged the jurisdiction of arbitral tribunals in these cases on the basis that the Russia-Ukraine BIT did not protect investments of Ukrainian nationals in Crimea. While the region was formally annexed by Russia to its territory, Russia argued that Crimea was not part of Russia's sovereign territory within the meaning of the Russia-Ukraine BIT. Claimants, on the other hand, contended amongst other arguments that good faith prevented Russia from arguing that the Russia-Ukraine BIT did not protect investments of Ukrainian nationals in Crimea because this was contradictory to Russia's own acts and declarations pertaining to the annexation of the region.

A few decisions rendered in these arbitral proceedings were not made public, including the recent Award on Jurisdiction of 5 August 2024 rendered in *NPC Ukrenergo v. Russian Federation, PCA Case No. 2020-17*. However, in at least three decisions under the Russia-Ukraine BIT, arbitral

tribunals dealt with the issue of good faith as a matter of treaty interpretation. In two of them, arbitral tribunals relied on good faith to decide that Russia could not act contradictorily, arguing that Crimea was not part of Russia's territory within the meaning of the Russia-Ukraine BIT at the same time that Russia claimed the annexation of the region into its territory. In this sense, in the Award on Jurisdiction of 26 June 2017 rendered in *Stabil LLC and Others v. Russian Federation*, PCA Case No. 2015-35, the tribunal considered that:

> "insofar as the principle of good faith calls for the opposability of the Treaty to Russia with respect to foreign investment presently located in Crimea. Indeed, Russia cannot at the same time claim that Crimea forms part of its territory and deny the application of a Treaty that it has concluded to protect investments made on its territory, without incurring an inconsistency contrary to good faith and the principle of consistency".

Similarly, in the Award of 1 November 2023 rendered in *JSC DTEK Krymenergo v. Russian Federation*, PCA Case No. 2018-41, the tribunal pointed out that:

> "[when] the VCLT requires that treaties be interpreted in good faith, it implies that constructions which lead to contradictory positions must be rejected".

In *NJSC Naftogaz of Ukraine and others v. Russian Federation*, PCA Case No. 2017-16, the tribunal went further. In the Partial Award of 22 February 2019, the tribunal relied on "a good faith interpretation" to advance an argument clearly based on a sentiment of justice or morality, according to which it would not be right for Russia to deny protection to Ukrainian investors in Crimea under the Russia-Ukraine BIT. According to the tribunal:

> "[it] is not a good faith interpretation of the Treaty to suggest that Russia, having taken over Crimea by force of arms, thereby depriving the Claimants and other Crimea investors of the legal protection of Ukrainian law and Ukrainian judicial institutions, to deny treaty protection to investors, which, by the unilateral act of one of the Contracting Parties, have become foreign investors".

Good Faith in the VCLT

There is no question that the VCLT requires States to carry out their treaty obligations in good faith. In this sense, Article 26 of the VCLT provides that "[every] treaty in force is binding upon the parties to it and must be performed by them in *good faith*". Likewise, there is no question that Article 31(1) of the VCLT requires a treaty to be interpreted in good faith, where it provides that "[a] treaty shall be interpreted in *good faith*". However, Articles 26 and 31(1) of the VCLT govern two different situations. Article 26 of the VCLT refers to the *performance* of the treaty, while Article 31(1) of the VCLT refers to the *interpretation* of the treaty. That is to say that Article 26 of the VCLT governs the conduct of the parties to the treaty in relation to the performance of their

obligations under the treaty, whilst Article 31(1) of the VCLT governs the way in which the treaty has to be interpreted. Good faith in Article 31(1) of the VCLT refers to a duty placed on the interpreter to apply the general rule of interpretation in good faith, and it does not add an independent element for establishing the correct meaning of the treaty based on the conduct of one or more parties to the treaty.

The duty of good faith placed on the interpreter can be illustrated by the case where the general rule of interpretation allows the interpreter to establish a meaning that is not ambiguous or obscure, but the interpreter chooses to interpret the treaty in a way that leaves the meaning of the treaty ambiguous or obscure to avoid the application of the general rule of interpretation. In this case, the interpreter is not acting in good faith. Another example is when the interpreter prefers to adopt an interpretation that leaves a provision of the treaty ineffective, whilst the general rule of interpretation allows the interpreter to establish a meaning that makes the same provision of the treaty effective.

Arbitral tribunals, however, tend to mix Articles 26 and 31(1) of the VCLT, as if these provisions had the same function. In *Stabil LLC and Others v. Russian Federation*, the tribunal relied on the reference to good faith in Article 31(1) of the VCLT to assert that "[the] principle of good faith is […] a universally recognized cornerstone of treaty interpretation" and "is the source of several other international legal principles, such as 'the rule *pacta sunt servanda* and other legal rules distinctively and directly related to honesty, fairness and reasonableness'", and "the principle of consistency and the Latin maxim of *allegans contraria non audiendus est* (colloquially translated as 'one cannot blow hot and cold')", failing to explain whether Article 31(1) of the VCLT alone allowed the tribunal to apply all "other international legal principles" as a matter of treaty interpretation. Likewise, in *JSC DTEK Krymenergo v. Russian Federation*, the tribunal asserted that "[the] principle of good faith in the interpretation and performance of the BIT does not advance Russia's position", without making any distinction between Articles 26 and 31(1) of the VCLT, and without explaining the relevance of each provision for the decision taken by the tribunal.

In addition to the fact that this approach is inconsistent with the general rule of interpretation, it creates the risk of arbitral tribunals importing into investment treaties obligations that the parties have not consented to be bound by, undermining the consensual nature of public international law on which the VCLT is based. It also risks the fragmentation of treaty obligations, given that arbitral tribunals would confer a different meaning on the treaty depending on the party involved as if the duty of good faith could lead to a sort of *constructive reservation* capable of modifying the legal effect of certain provisions of the treaty in their application to a party that behaved in a particular way.

This does not mean that the conduct of a party is irrelevant to the interpretation of treaty provisions. Article 31(3)(b) of the VCLT provides that "any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation" has to be taken into account together with the context of the treaty. While Article 31(3)(b) of VCLT requires the practice to establish the agreement of all parties to the treaty, the unilateral act of a single party may qualify as subsequent practice in the sense of Article 31(3)(b) of the VCLT if the other party acquiesced in such act. In this circumstance, the conduct of the party will be relevant for the interpretation of treaty provisions because it establishes the agreement of the parties to the treaty and not because of the duty to perform treaty obligations in good faith.

Likewise, this does not mean that arbitral tribunals are not allowed to assess the consequences resulting from a party not performing treaty obligations in good faith, nor are arbitral tribunals prevented from holding States accountable for the breach of unilateral declarations that can create legal obligations. But in these circumstances, it will not be a matter of treaty interpretation pursuant to Article 31(1) of the VCLT.

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This entry was posted on Friday, October 4th, 2024 at 8:09 am and is filed under Crimea, Good Faith, Interpretation, Investment Treaties, Treaty Interpretation, VCLT
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