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by

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A Focus on BITs

Drawing the Right Lessons from ICSID Jurisprudence on the Doctrine of Necessity

by AMIN GEORGE FORJI*

1. INTRODUCTION

Bilateral investment treaties (BITs) and the International Centre for the Settlement of Investment Disputes (ICSID) have over the years injected an important dynamic into public international law, that is, the replacement of a political remedy (peaceful cooperation amongst nations) by a legal one (settlement of investment disputes). The institution of ICSID and the revision of BITs in line with its rules have opened the way for direct investors' claims and investor-state arbitration. The obvious implication of a compulsory arbitration provision is that it has made up for many shortcomings of the diplomatic protection mechanism with,

“the potential for an individual investor, with or without the approval of its home government, to press a conflict that may ultimately have diplomatic implications and may affect relations between the two countries concerned”.¹

It is however still debated whether such a mechanism guarantees fairness and equity for both investors and host states, or merely advantages one BIT signatory to the detriment of the other.

Argentina has had more cases before the ICSID tribunals than any other country. Faced with an economic crisis in 2001–2002, it ran into conflict with foreign investors when it repealed the Convertibility Law on which most of its BITs had been negotiated. Could that action be justified as one taken in times of peril and in dire need, as sanctioned by international law, or was it just an outright breach of Argentina's own contractual commitments?

2. BACKGROUND: TOWARDS INVESTMENT ARBITRATION

By 2008 2,600 BITs had been signed, with over 1891 entering into force.² It has become uniform practice to refer disputes arising from BITs to a neutral arbitration tribunal, ICSID being the most common forum. ICSID came to being in 1965, barely six years after the first BIT between Germany and Pakistan was signed in 1959. Its first hearing was in 1972.³ BITs are pacts that dealt exclusively with foreign investment.⁴ Before long, they were reformulated

* The author wishes to thank Professor Martti Koskeniemi (Helsinki University) for his constructive comments on earlier drafts of this article.

¹ Jeswald Salacuse, “Bit by Bit: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries” (1990) 24 *The international Lawyer* 655, 673.

² R.T. Greig, Claudia Annacker and Roland Ziadé, “How Bilateral Investment Treaties Can Protect Foreign Investors in the Arab World or Arab Investors Abroad” (2008) 25 *Journal of International Arbitration* 257.

³ *Swiss Corp Holiday Inns SA Glarius v American Corp Occidental Petroleum Corp* Unreported 1972.

⁴ See generally Andrew Guzman, “Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties” (1998) 38 *Virginia Journal of International Law* 639.

to take advantage of the dispute settlement mechanisms afforded by ICSID and related bodies such as the ICC and UNCITRAL. To date 155 countries have signed the ICSID Convention, 143 of them have ratified.⁵

Until the 1960s, the resolution of all commercial and investment disputes was by state-to-state dispute resolution. The procedure was not always convenient. States would normally first seek relief from the host state and only if that failed would they then invoke diplomatic protection. That not only left stateless individuals with no relief at all but tempted states to politicise disputes, thus increasing international friction.⁶ The compulsory arbitration provision has,

“the potential for an individual investor, with or without the approval of its home government, to press a conflict that may ultimately have diplomatic implications and may affect relations between the two countries concerned”.⁷

3. ICSID REGIME IN PERSPECTIVE

The choice of the World Bank as the appropriate forum for dispute settlement is justified on the grounds that it depoliticises disputes, reducing the risk of souring international relations.⁸ Modern BITs have now come to terms with what I will term a consensual rule mechanism, a voluntary process by which the state and investors willingly commit their disputes to international arbitration. The watchword of this new *modus operandi* is consent. ICSID has facilitated this unusual procedure, enabling the conciliation and arbitration of investment disputes based on consent.⁹ The possibility of investors' direct access and absence of a government filter mean that such a tribunal would be flooded with claims, some of which would be dishonest. The consent requirement is important not only to prevent abuse but also to limit the competence of the tribunal.¹⁰ Article 25(1) limits the jurisdiction of the Centre to¹¹:

“[A]ny legal dispute arising directly out of an investment, between a contracting state (or any constituent subdivision or agency of a contracting state designated to the centre by that state) and a national of another contracting state, which the parties to the dispute consent in writing to submit to the centre. When the parties have given their consent, no party may withdraw its consent unilaterally.”

“Legal dispute arising directly out of an investment” not only makes investment the keystone of the ICSID convention but also requires that the dispute must be “legal” and “arising

⁵ Full list available at <http://icsid.worldbank.org/ICSID/ICSID/DocumentsMain.jsp> [Accessed June 1, 2009].

⁶ Won-Mog Choi, “The present and future of the Investor-State Dispute Settlement Paradigm” (2007) 10 *Journal of International Economic Law* 727.

⁷ Jeswald Salacuse, “Bit by Bit” (1990) 24 *The International Lawyer* 655, 673.

⁸ Anthony C. Sinclair, “ICSID’s Nationality Requirements in Investment Treaty Arbitration and International Law” in Grierson Weiler (ed.), *Investment Treaty Arbitration and International Law* (New York: Juris Publishing LLC, 2008), p.85.

⁹ Ibrahim Shihata and A.R. Parra, “The Experience of International Center for the Settlement of Investment Disputes” in “ICSID Convention: a Commentary” (1999) 14 *ICSID-Foreign Investment L.J.* 299.

¹⁰ Nurzat Myrsaliev, “Jurisdictional Challenges in Investor-State Arbitration: Analysis of Typical Provisions in Bilateral Investment Treaties with Specific Reference to the Treaty between the US and the Kyrgyz Republic” (2005) 7 *European Journal of Law Reform* 429, 430.

¹¹ ICSID Convention art.25.

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directly out of” an “investment”.¹² Article 25 is the basic rule that determines the ICSID jurisdiction and that of its tribunals.¹³ It sets the limits of the types of transactions that qualify for ICSID treatment to “investment” only.¹⁴ Is it therefore not a paradox that the Convention does not describe what constitutes an investment? Even in modern BITs, the term is still far from having a generally accepted meaning. Instead, what each BIT does is limit its own definition of investment to the intent of the parties, or define investments in part by reference to the investors covered under the treaty.¹⁵ The Executive Directors in their report on the *travaux préparatoires* did not hide this deliberate omission¹⁶:

“[N]o attempt was made to define the term ‘investment’ given the essential requirement of consent by the parties, and the mechanism through which Contracting States can make known in advance, if they so desire, the classes of disputes which they would or would not consider submitting to the Centre.”

4. THE ARGENTINE FINANCIAL CRISES OF LATE 2001/EARLY 2002

Ever since attaining independence from Spain in 1816, Argentina has suffered a cycle of political and economic instability.¹⁷ Towards the beginning of the 1990s, like most developing countries at the time it was struggling to recover from the debt crises of the past decade. Most sectors of the economy were liberalised, as a means of attracting foreign investments. To entice western investors, Argentina passed the “convertibility law”.¹⁸ One effect was to peg the local currency (peso) one-to-one against the US dollar. The benefits, it was argued at the time, were twofold: to prevent the state from financing deficits by printing new currency and to keep inflation under control.¹⁹

Argentina quickly took the lead in signing BITs in Latin America, most of which not only provided for arbitration through ICSID but were ratified and promulgated into law barely four years afterwards.²⁰ By August 2002, Argentina had already signed 38 BITs, 26 of them in force.²¹ It signed the ICSID Convention in May 1991, which came into force in November 1994. Encouraged by these new investment-friendly measures, foreign

¹² Devashish Krishan, “A Notion of ICSID Development in Investment Treaty Arbitration and International Law” in Grierson Weiler (ed.), *Investment Treaty Arbitration and International Law*, 2008, p.61.

¹³ R.E. Vinuesa, “Bilateral Investment Treaties and the Settlement of Investment Disputes under ICSID: The Latin American Experience, NAFTA” (2002) 8 *Law and Business Review of the Americas* 503.

¹⁴ Vinuesa, “Bilateral Investment Treaties and the Settlement of Investment Disputes under ICSID” (2002) 8 *Law and Business Review of the Americas* 503.

¹⁵ See Antonio Parra, “The Scope of New Investment Laws and International Instruments” in R. Pritchard (ed.), *Economic Development, Foreign Investment and the Law* (New York: Kluwer Law International, 1996), p.31.

¹⁶ “Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of other States, in Convention on the Settlement of Investment Disputes between States and Nationals of Other states” (1965) 4. I.L.M para.27

¹⁷ See D.A. Krawiec, “Reaffirming the Rights of Foreign Investors to the Protection of ICSID Arbitration: *Sempra Energy International v the Argentine Republic*” in *ExpressO*: http://works.bepress.com/daniel_krawiec/1 [Accessed April 24, 2009].

¹⁸ Law 23/928 of March 27, 1991 (amended by Law 25/445 of June 21, 2001).

¹⁹ Paolo Di Rosa, “The Recent Wave of Arbitrations against Argentina under Bilateral Investment Treaties: Background and Principal Legal Issues” (2004) *Inter-American L.R.* 44, 47.

²⁰ Paolo Di Rosa, “The Recent Wave of Arbitrations against Argentina under Bilateral Investment Treaties: Background and Principal Legal Issues” (2004) *Inter-American L.R.* 44, 47.

²¹ <http://www.worldbank.org/icsid/treaties.htm> [Accessed, June 10, 2009].

multinational corporations invested heavily in various sectors of the Argentine economy, including hydrocarbons, electricity, harbours, water and gas.

By late 2001, Argentina was rocked by financial crises. Inflation skyrocketed by the day, as unemployment rose to over 25 per cent. Not only did income per person shrink from around US \$7,000 to just \$3,500, over half of the population was living below the poverty line.²² Banks were on the verge of collapse.²³ The country defaulted on its US \$155 billion public debt, the largest non-payment by any country in history.²⁴ Angered by the crises, the people took to the streets.²⁵

The Government responded by enacting the Public Emergency Laws 2002²⁶ as a means of restoring economic assurance, stability and political order. This devalued the peso by 40 per cent and abandoned the convertibility monetary regime that pegged the peso to the US dollar.²⁷ In normal circumstances, such a law would constitute a legitimate sovereign right but it disregarded the commitments in BITs, by fundamentally altering the economic and financial framework in which those treaties were signed and on which foreign investors relied.

Forty-eight cases have been filed against Argentina before ICSID tribunals for breach of obligations under 1980s and 1990s BITs²⁸ which not only spelt out guarantees for foreign investors but accorded them investor-to-state arbitration before ICSID tribunals. Some estimates in 2006 valued the cases against Argentina at over US \$1.8 billion.²⁹ Most have targeted three main areas of the Emergency Laws: the institution of provincial taxes, contrary to the concessions, e.g. the cases by Enron and CMS 2001³⁰; the Economic Emergency Law on the *pesification* of charges (that is the freezing of charges for public services)³¹; and the application of petroleum export retentions in 2002.³²

Argentina has so far lost all the finalised lawsuits at ICSID. If the trend continues, it will lose at least US \$80 billion, far more than its entire financial reserve in 2002.³³ Is it therefore in Argentina's or investors' interests to delegate dispute resolution to a third party? The last decade has witnessed the proliferation of BITs and it is during this decade that they are really being tested by these arbitration cases, "both the limits of state freedom of action and investor protections under the BIT regime in exceptional circumstances".³⁴ Argentina

²² "Argentina's Collapse: a Decline without Parallel" in *The Economist*, March 2–8, 2002, p.26.

²³ "Argentina's Collapse" in *The Economist*, March 2–8, 2002, p.26.

²⁴ "Argentina's Collapse" in *The Economist*, March 2–8, 2002, p.25.

²⁵ "Argentina's Collapse" in *The Economist*, March 2–8, 2002, p.25.

²⁶ Law 25.561 of January 7, 2002 and Decree 214/2002 of February 4, 2002.

²⁷ William Burke-White, "The Argentine Financial Crises: State Liability under BITs and the Legitimacy of the ICSID system" in *University of Pennsylvania Law School Newsletter* (January 2008), p.2.

²⁸ <http://www.worldbank.org/icsid/cases/pending.htm> [Accessed May 30, 2009].

²⁹ See Alec Stone Sweet, "Investor-State Arbitration: Proportionality's New Frontier". Available online: http://works.bepress.com/cgi/viewcontent.cgi?article=1030&context=alec_stone_sweet [Accessed November 23, 2009].

³⁰ See Ricardo Ortiz, "The Bilateral Investment Treaties and the Cases at ICSID: The Argentine Experience at the Beginning of the XXI Century" (Sept. 2006) F.O.C.O. (*Foro Ciudadano de Participación por la Justicia y los Derechos Humanos, Argentina* 21.

³¹ Ortiz, "The Bilateral Investment Treaties and the Cases at ICSID" (Sept. 2006) F.O.C.O. 21.

³² Ortiz, "The Bilateral Investment Treaties and the Cases at ICSID" (Sept. 2006) F.O.C.O. 21.

³³ See Todd Allee and Clint Peinhardt, "Delegating Differences: Bilateral Investment Treaties and Patterns of Dispute Resolution Design" (2007), paper presented at the 2007 annual meeting of the International Studies Association in Chicago, p.16; see also William Burke-White, "The Argentine Financial Crisis" in *University of Pennsylvania Law School Newsletter*, January 2008, p.5.

³⁴ See William Burke-White, "The Argentine Financial Crises" in *University of Pennsylvania Law School Newsletter*, January 2008, p.2.

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shows the pitfalls for two major reasons: not only does it lead in Latin America but it has the highest number of signed BITs in the entire world.³⁵ It also leads in the number of cases at ICSID, with 20 per cent of all cases.³⁶ Secondly, the legal and political questions which have followed Argentina's defences to these cases. It has invoked various legal arguments to justify the emergency laws as measures taken during exceptional circumstances which, it has argued, treaty law allows a state to take.³⁷

5. ICSID JURISPRUDENCE AND LEGAL ISSUES

CMS Gas v Argentina³⁸

CMS, an American subsidiary of the private Argentinian gas corporation Transportadora de Gas del Norte (TGN),³⁹ sued the state of Argentina for breach of obligations under the 1994 US–Argentina BIT. CMS acquired its shares in TGN through a privatisation scheme in the aftermath of the “convertibility law” that provided that gas tariffs would be calculated in US dollars.⁴⁰ CMS argued that the emergency legislation had violated art.II(2) of the US–Argentina BIT⁴¹ by breaching the fair and equitable treatment clause and non-discrimination provisions and that the Government had expropriated gas investments in TGN without full compensation⁴² and claimed US \$26.1 million damages.⁴³

The Government justified its actions on grounds of public considerations, arguing that the agreements with TGN provided “only for the right of the licensee for a fair and reasonable tariff... but excluding altogether financial costs”.⁴⁴ By undertaking to invest in Argentina, CMS was committing itself to the potential risk that domestic policies would change in the event of serious financial crises.⁴⁵ It claimed exemption from liability under its BITs, not only because of the catastrophic crises but also because as a nation it had a discretion to act on “public considerations” to regulate gas tariffs.⁴⁶ The tribunal ruled in favour of CMS on the ground that art.II(2) of the US–Argentina BIT, requiring the treatment of US companies in a fair and equitable manner, had been breached.⁴⁷

³⁵ Of the 43 cases, five have already been finalised, with 38 still pending, see Ortiz, “The Bilateral Investment Treaties and the Cases at ICSID” (September 2006) F.O.C.O. 9.

³⁶ Ortiz, “The Bilateral Investment Treaties and the Cases at ICSID” (Sept. 2006) F.O.C.O. 9.

³⁷ See William Burke-White, “The Argentine Financial Crises” in *University of Pennsylvania Law School Newsletter*, January 2008, p.2.

³⁸ *CMS Gas Transmission Co v Argentina* Case No.ARB/01/8 ICSID (2005).

³⁹ CMS owns 30% shares in the TGN venture.

⁴⁰ See Graham Mayeda, “Playing Fair: the Meaning of Fair and Equitable Treatment in Bilateral Investment Treaties” (2007) 41 *Journal of World Trade* 273, 276.

⁴¹ US–Argentina BIT art.II(2): “a) Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law. b) Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments. For the purposes of dispute resolution under Articles VII and VIII, a measure may be arbitrary or discriminatory notwithstanding the opportunity to review such measure in the courts or administrative tribunals of a Party. c) Each Party shall observe any obligation it may have entered into with regard to investments.”

⁴² Graham Mayeda, “Playing Fair” (2007) 41 *Journal of World Trade* 273, 276.

⁴³ paras 88–89.

⁴⁴ para.91.

⁴⁵ Graham Mayeda, “Playing Fair” (2007) 41 *Journal of World Trade* 273, 277.

⁴⁶ para.93.

⁴⁷ See para.266.

LG&E Energy Corporation v Argentine Republic⁴⁸

Like the *CMS* case, the issues in *LG&E* originated from Argentina's financial crises of 2001–2002 and ensuing emergency legislation. *LG&E* was a US power company that had participated in the privatisation programme of Argentina's gas sector. The claim was against the state of Argentina for breaching the fair and equitable treatment and umbrella clauses as well as alleged discriminatory conduct contrary to the 1991 US–Argentina BIT. *LG&E* blamed the great reduction in profitability on the 2002 emergency legislation. The tribunal accepted *LG&E*'s claim that suspension of the tax regime in the gas sector breached the fair and equitable standard and umbrella clause contained in the US–Argentina BIT. Despite the similarities between *CMS* and *LG&E*, the tribunals reached opposite conclusions on assessing the extent of the state of necessity. Although both ruled in favour of the plaintiffs, *LG&E* found Argentina to have been in a state of necessity between December 1, 2001 and April 26, 2003. The losses incurred during this period were therefore subtracted from the general damages.⁴⁹

6. BALANCING INTERESTS: TREATY OBLIGATIONS VERSUS STATE OF NECESSITY

In all the cases before ICSID, while admitting that the emergency laws had the potential to cause harm to investors, Argentina nonetheless presented other legal defences. The argument was that exceptional measures had been taken during exceptional financial crises; not only were they in line with the non-precluded measures (NPM) in the BITs, they were tailored to meet the exigencies of the “state of necessity”, as evidenced by customary international law.⁵⁰

Despite the virtually identical facts and circumstances surrounding *CMS* and *LG&E*, the tribunals came to opposite conclusions. Both tribunals agreed on substantive obligations arising under the BIT (fair and equitable treatment standard, umbrella clause, non-discrimination). Both tribunals also assessed the application of the NPM clause and the state of necessity in the context of Argentina's defences, yet they reached contradictory decisions. Although both tribunals recognised the seriousness of the crises, *CMS* concluded that the requirements for the state of necessity had not been fully met.⁵¹ The *LG&E* tribunal contradicted this view by ruling that it is the aggregate of devastating economic, political and social conditions that triggered the protections afforded under art.XI of the Treaty.⁵²

Both *CMS* and *LG&E* provoked legal concerns which are crucial for the future of investor-to-state arbitration. Were the measures adopted by Argentina to respond to the economic crises legally correct? Was the contradiction in the *CMS* and *LG&E* tribunals suggestive of a deficiency or ambiguity in relying on ICSID as a neutral institution for the settlement of investment disputes? In other words, do the concepts of NPM and state of necessity symbolise a gateway from peril or are they merely self-contradictory, legally speaking?

It is imperative first to understand what NPM and state of necessity mean. In a BIT, NPM signifies that taking such a measure is not prohibited and does not breach the instrument.⁵³ Necessity in “state of necessity” implies the employment of what is necessary

⁴⁸ *LG&E Energy Corp v Argentine Republic* Case No.ARB/02/01 ICSID (2006).

⁴⁹ *LG&E* Case No.ARB/02/01 ICSID (2006) at [229], [230]. Despite the subtraction, the compensation was fixed at US \$57.4 million.

⁵⁰ Michael Waibel, “Two Worlds of Necessity in ICSID Arbitration: *CMS* and *LG&E*” (2007) 20 *Leiden Journal of International Law* 637; art.XI of the US–Argentina BIT.

⁵¹ *CMS* Case No.ARB/01/8 ICSID (2005) at [315].

⁵² *LG&E* (2006) Case No.ARB/02/01 ICSID at [237].

⁵³ Gabriel Bottini, “Protection of Essential Interests in the BIT Era” in Todd Weiler (ed.), *Investment Treaty Arbitration and International Law* (Huntingdon, NY: Juris, 2008), Vol.1, p.148.

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or indispensable.⁵⁴ Necessity is a well-grounded concept in customary international law: it requires an indispensable measure to be taken in order to safeguard and protect national interest from imminent peril. As far back as 1923, the Permanent Court of International Justice (PCIJ) in *S.S. Wimbledon*⁵⁵ vindicated the principle of self-preservation as a fundamental principle of international law:

“[T]he right of a state to adopt the course which it considers best suited to the exigencies of its security and to the maintenance of its integrity, is so essential a right that, in case of doubt, treaty stipulations cannot be interpreted as limiting it.”⁵⁶

The International Law Commission (ILC) Articles on State Responsibility (ILC Articles) art.25 has included state of necessity as one of the six circumstances precluding the wrongfulness of a state⁵⁷:

“1) Necessity may not be invoked by a state as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that state unless the act:

- (a) Is the only means for the state to safeguard an essential interest against a grave and imminent peril; and
- (b) Does not seriously impair an essential interest of the state or states towards which the obligation exists, or of the international community as a whole.”⁵⁸

My submission is that, while *LG&E* represents a sound judgment, that in *CMS*, which has been embraced by the majority of subsequent tribunals, is an error in law on many fronts, at least as far as the defence of necessity. The two cases were similar. The tribunals in both cases were faced not only with the same BIT, but also with identical facts and the same economic measures by the state of Argentina. The fact that arbitrators have in each case taken contradictory positions on the important question of when and to what extent a state can invoke the defence of necessity raises more concerns than answers.

Despite *LG&E*'s making the defence of necessity available, some observers have already predicted that that would be looked on as an aberration.⁵⁹ Subsequent cases have followed *CMS* for the most part, gradually eroding the defence of necessity. The tribunal in *Sempra*⁶⁰ reaffirmed the reasoning in *CMS* by rejecting both the NPM clause and the necessity defence as inapplicable. The *Enron* tribunal rejected the necessity defence, stating that:

“[T]he argument that such a situation compromised the very existence of the state and its independence so as to qualify as involving an essential interest of the state is not convincing.”⁶¹

⁵⁴ Théodore Christakis, “Nécessité n’a pas de Loi? La Nécessité en Droit International, Rapport Général” in *La Nécessité en Droit International, Colloque de Grenoble de la Société Française pour le Droit International* (Paris: Pedone, 2007) p.7. cf. Gabriel Bottini, “Protection of Essential Interests” 160.

⁵⁵ *S.S. Wimbledon (Great Britain, France and Japan v Germany)* (1923) 1 P.C.I.J. 37.

⁵⁶ cf. Gabriel Bottini, “Protection of Essential Interests” 145.

⁵⁷ cf. Michael Waibel, “Two Worlds of Necessity” (2007) 20 *Leiden Journal of International Law* 637, 640; the International Law Commission Articles on State Responsibility six circumstances are consent (art.20), self-defence (art.21), countermeasures (art.22), force majeure (art.23), distress (art.24) and necessity (art.25).

⁵⁸ ILC Articles art.25(1), UN Doc.A/56/10, 2001.

⁵⁹ See David Schneiderman, “Judicial Politics and International Investment Arbitration: Seeking an Explanation for Conflicting Outcomes” (unpublished manuscript, 2008), p.3.

⁶⁰ *Sempra Energy International v Argentine Republic* Case No.ARB/02/16 ICSID.

⁶¹ *Enron Corp and Ponderosa Assets v Argentina* Case No.ARB/01/3 ICSID (2007) at [306].

The *CMS* acceptance of the defence of necessity was an error in law on several fronts and *LG&E* is to be preferred for the following reasons. First, *CMS* did not separate the NPM clause in the BIT from the customary international law defence of necessity. Instead, it read art.XI of the BIT with reference to art.25 of the ILC Articles.⁶² Like the *CMS* tribunal, the arbitrators in *Sempra* and *Enron* followed the same reasoning by absorbing art.XI of the US–Argentina BIT into the defence of necessity, instead of treating it as *lex specialis* or a source of law.⁶³ The tribunal in *LG&E* on the other hand clearly separated NPM from the defence of necessity. It is probably this separation that enabled the arbitrators to see the facts at stake more closely. Like the *CMS* tribunal, the *LG&E* tribunal also found Argentina to have breached the fair and equitable treatment standard, but, to get to that conclusion, treated NPM under art.XI of the BIT separately from the necessity defence in art.25 of the ILC Articles.⁶⁴

This shows that tribunals are likely to arrive at one or other conclusion depending on whether they first employ NPM as the primary point for assessing the emergency of the situation and art.25 as a subsidiary consideration, or vice versa. The *CMS* tribunal relied on the ILC necessity requirement first, absorbing the NPM in the BIT into art.25. The *LG&E* tribunal relied first and foremost on the BIT’s emergency clause and considered the customary law concept of necessity only secondarily.⁶⁵ It made more sense to first interpret the spirit of the BIT in question before other sources of international law. *LG&E* obviously adopted a more sound approach. It is also common sense in international law that treaty law (BIT) should prevail over customary international law (ILC Articles). It has been observed that this crucial difference,

“affected the assessment of whether compensation was due to the foreign investor even where conditions for the defense of necessity had been met”.⁶⁶

The *CMS* award failed to provide any convincing reason why it chose to resolve NPM into the customary international law defence of necessity. The two concepts although related are different.⁶⁷ While the defence of necessity under customary international law is premised on the ground that,

“a violation of a rule of international law has taken place. . . [NPM] constitute inescapable evidence that, if a measure in question is within the scope of those provisions, the state has not breached the BIT”.⁶⁸

⁶² *CMS* Case No.ARB/01/8 ICSID (2005) at [353]–[358].

⁶³ See Alec Stone Sweet, “Investor-State Arbitration”, available online: http://works.bepress.com/cgi/viewcontent.cgi?article=1030&context=alec_stone_sweet [Accessed November 23, 2009], p.20.

⁶⁴ Alec Stone Sweet, “Investor-State Arbitration”, available online: http://works.bepress.com/cgi/viewcontent.cgi?article=1030&context=alec_stone_sweet [Accessed November 23, 2009], p.21.

⁶⁵ S.W. Schill, “International Investment Law and the Host State’s Power to Handle Economic Crises; Comment on the ICSID Decision in *LG&E v. Argentina*” (2007) 24 *Journal of International Arbitration* 278.

⁶⁶ Schill, “International Investment Law and the Host State’s Power to Handle Economic Crises” (2007) 24 *Journal of International Arbitration* 278.

⁶⁷ According to Gabriel Bottini, “Protection of Essential Interests”, p.154, the conditions laid out in the ILC’s Draft Articles are foreign to art.XI; see also *CMS* Case No.ARB/01/8 ICSID (2005) award at [130].

⁶⁸ Gabriel Bottini, “Protection of Essential Interests”, 148.

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Naturally, any accepted plea under art.XI precludes the finding of any breach of the BIT.⁶⁹

The second most crucial difference between *CMS* and *LG&E* is the way the two tribunals appreciated the threat of the crises on public order and security. Here again, the CMS tribunal accepted a false argument. The economic crisis, the tribunal held, was not severe enough to warrant the invocation of the BIT emergency clause. Though catastrophic the crisis was not a threat of “total economic and social collapse”.⁷⁰ This conclusion emanated from the *CMS* tribunal’s refusal to treat BIT NPM clauses as *lex specialis*, standing apart from customary international law. Had it done so, it would have considered the stakes of public order and security more seriously. This is exactly the way of thinking that the tribunal in *LG&E* adopted:

“To conclude that such a severe economic crisis could not constitute an essential security interest is to diminish the havoc that the economy can wreak on the lives of an entire population and the ability of the government to lead. When a state’s economic foundation is under siege, the severity of the problem can equal that of any military invasion.”⁷¹

Article XI contains the treaty’s NPM, aimed at permitting:

“[T]he 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 and Security, or the protection of its own essential security interests.”

This wording clearly suggests an intention to render state measures that meet the requirements laid down in art.XI lawful under the BIT,

“even if such measures would breach rights provided to investors in other parts of the treaty, such as the Fair and Equitable Treatment standard (Article II of the US-Argentina BIT)”.⁷²

The mere presence of the NPM in the BIT is an indication of the signatories’ intention to emphasise the legitimate regulatory interests of the host state during an emergency situation.⁷³ To somehow reinterpret art.XI to suggest that NPM did not apply in the crisis faced by Argentina would be tantamount to signifying that the parties actually signed the BIT in bad faith, with hidden intention not to be committed to the NPM exception in the treaty. Article 31(1) of the Vienna Convention commands all treaties to be,

“interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty of their context and in light of its object and purpose”.⁷⁴

The concept of good faith forms the basis of the fair and equitable treatment standard. The right interpretation of art.XI is that it enables the host state to take exceptional actions,

⁶⁹ Alec Stone Sweet, “Investor-State Arbitration”, available online: http://works.bepress.com/cgi/viewcontent.cgi?article=1030&context=alec_stone_sweet [Accessed November 23, 2009], p.21.

⁷⁰ *CMS* Case No.ARB/01/8 ICSID (2005) at [320], [355].

⁷¹ *LG&E* Case No.ARB/02/01 ICSID (2006) at [238].

⁷² Alec Stone Sweet, “Investor-State Arbitration”, available online: http://works.bepress.com/cgi/viewcontent.cgi?article=1030&context=alec_stone_sweet [Accessed November 23, 2009], p.19.

⁷³ Gabriel Bottini, “Protection of Essential Interests”, 148.

⁷⁴ Vienna Convention on Law of Treaties 1969 art.31(1).

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“otherwise inconsistent with the treaty when for example, the actions are necessary for the protection of essential security, the maintenance of public order, or to respond to a public health emergency”.⁷⁵

It is only through such measures (NPM) that BITs can be kept in check and prevented from acting as instruments for regulating host state governments.⁷⁶

An ad hoc committee set up to review the *CMS* ruling found it hard to comprehend its interpretation of NPM. It said that, if an NPM provision applies, then there is no breach of the BIT⁷⁷ :

“In such a situation, there is no reason for the state to pay compensation. If the state can only rely on the state of necessity but not on NPM provision, it may or may not have to pay compensation, depending on the circumstances.”⁷⁸

Article 25 provides strict conditions under which a state can invoke the defence of necessity. It requires that the unlawful act must be “the only means for the state to safeguard an essential interest against a grave and imminent peril”. The intention of the article is to excuse a state facing such a peril for not living up to its international obligations.⁷⁹ The defence is limited to the period of necessity only, after which the suspended obligation would be expected to become binding again.⁸⁰ Both tribunals should have been concerned to examine the claim of Argentina in terms of whether the conditions of the clause were reasonably met, or whether they were exploited for political ends, instead of trying to challenge the suitability of the concept as a whole, as the *CMS* tribunal did. The *LG&E* tribunal on the other hand rightly gave weight to the situation at hand and, upon finding that both the doctrine of necessity and the NPM clause in the US–Argentina BIT provided Argentina with an excuse, partially excused Argentina for failing to live up to prior contractual commitments.⁸¹ It stated the defence of necessity “should be only strictly exceptional and should be applied exclusively when faced with extraordinary circumstances”.⁸² Given that the spirit of the necessity defence is to serve as a temporal measure, “the only way of safeguarding an essential interest”, *LG&E* must be applauded. Even the *CMS* tribunal did acknowledge the obvious, which is that the defence of necessity must be a temporary measure:

⁷⁵ William Burke-White, “The Argentine Financial Crises” in *University of Pennsylvania Law School Newsletter*, January 2008, p.6.

⁷⁶ Kenneth Vandervele, “Of Politics and Markets: the Shifting of Ideology of the BITs” 11 *International Tax and Business Law* 159, 170; cf. William Burke-White, “The Argentine Financial Crises” in *University of Pennsylvania Law School Newsletter*, January 2008, p.6.

⁷⁷ *CMS Case No.ARB/01/8 ICSID (2005) Annulment*, at [133]; cf. Gabriel Bottini, “Protection of Essential Interests”, 154.

⁷⁸ *CMS Case No.ARB/01/8 ICSID (2005) Annulment* at [146]–[147]; cf. Gabriel Bottini, “Protection of Essential Interests”, 154.

⁷⁹ Michael Waibel, “Two Worlds of Necessity” (2007) 20 *Leiden Journal of International Law* 637, 641.

⁸⁰ See R. Doak Bishop and Roberto Aguirre Luzi, “Investment Claims: First Lessons From Argentina, in *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law*” in Todd Weiler (ed.) (London: Cameron May, 2005), p.466.

⁸¹ *LG&E Case No.ARB/02/01 ICSID (2006) tribunal* limited the period of necessity to when the crisis began (December 2001) until the election of President Kirchner on April 26, 2003, when the economy was once more beginning to stand on its feet.

⁸² *LG&E Case No.ARB/02/01 ICSID (2006)* at [228], [263].

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“[E]ven if the plea of necessity were accepted, compliance with the obligation would re-emerge as soon as the circumstances precluding wrongfulness no longer existed, which is the case at present.”⁸³

The only difficulty with this ruling is that, by employing the phrase “even if the plea of necessity were accepted”, the tribunal was taking a firm stand not even to consider the defence in reaching its verdict.

The *CMS* ruling implies that the defence of necessity will be ill-suited for dealing with sovereign financial crises.⁸⁴ Nowhere in the ILC Articles does it suggest that the defence is applicable to all matters of national security interest, with the exception of financial crises. The requirement under art.25 ILC Articles is that the defence would become applicable where it is the only means of safeguarding an essential interest of the state against grave and imminent peril. The concern of both tribunals should have been to determine whether this test was met, instead of trying to somehow hint like the *CMS* tribunal did that the defence would be ill-suited to deal with economic financial crises. As the *LG&E* tribunal rightly observed, “the severity of the problem can equal that of any military invasion”.⁸⁵ The freezing of tariffs was crucial for resolving the unprecedented economic crisis.⁸⁶ If we accept the reasoning in *CMS* award as the guiding principle, it would be virtually impossible for a state in economic and financial peril ever to invoke the necessity defence: “no domestic economic crisis of whatever magnitude would qualify as a serious enough ‘peril’ to fall under the necessity doctrine”.⁸⁷ Both the *CMS* and the *LG&E* tribunals did well to recognise that the defence of necessity is only for exceptional situations of national security. But the *CMS* tribunal got it wrong in failing to recognise that the economic crisis Argentina was facing was not a normal crisis and warranted exceptional measures. We cannot reasonably expect a state in peril to wait until a disastrous peril fully matures before it reacts to it.

The *CMS* tribunal ruled that Argentina not only had other means but had significantly contributed to the economic crisis.⁸⁸ If these two claims were validated, there would be no reason not to give every credit to the *CMS* ruling. From the wording of art.25, the plea of necessity is available only where there are no other means. If other means are available, a state must employ them, even if they are more expensive and less convenient.⁸⁹ Moreover, the tribunal rightly ruled that a state would be disentitled from relying on the defence of necessity if it had significantly contributed to the crisis.⁹⁰

Some commentators have been quick to blast the *CMS* ruling, while at the same time hailing the decision in *LG&E* for its reasonableness. Schreuer has argued that the fair and equitable standard need not require that a host state freeze its legal system for the benefit of the investors.⁹¹ The historical significance of *S.S. Wimbledon*, is the affirmation by the PCIJ

⁸³ *CMS* Case No.ARB/01/8 ICSID (2005) at [382].

⁸⁴ See Michael Waibel, “Two Worlds of Necessity” (2007) 20 *Leiden Journal of International Law* 637, 638.

⁸⁵ *LG&E* Case No.ARB/02/01 ICSID (2006) Award at [238].

⁸⁶ See Michael Waibel, “Two Worlds of Necessity” (2007) 20 *Leiden Journal of International Law* 637, 638.

⁸⁷ See Alec Stone Sweet, “Investor-State Arbitration”, available online: http://works.bepress.com/cgi/viewcontent.cgi?article=1030&context=alec_stone_sweet [Accessed November 23, 2009], p.21.

⁸⁸ *CMS* Case No.ARB/01/8 ICSID (2005) at [304], [324], [329].

⁸⁹ See David Schneiderman, “Judicial Politics and International Investment Arbitration” (unpublished manuscript, 2008), p.5.

⁹⁰ *CMS* Case No.ARB/01/8 ICSID (2005) at [329].

⁹¹ C.H. Schreuer, “Fair and Equitable Treatment in Arbitral Practice” (2005) 6 *Journal of World Investment and Trade* 357; cf. Alec Stone Sweet, “Investor-State Arbitration”, available online: http://works.bepress.com/cgi/viewcontent.cgi?article=1030&context=alec_stone_sweet [Accessed November 23, 2009], p.6.

of the right of states to adopt measures to preserve their very existence.⁹² One commentator has summed up the dilemma of host states to embrace the regime of BITs with two competing theories of economic development. On the one hand, developing countries are required to liberalise their economies and provide guarantees for private investments; on the other, a state in the developing world is still the key stabilising agent, indispensable not only for economic growth but also existence.⁹³ The right of self-preservation is so important that no state can validly renounce it.⁹⁴ Consequently, if a tribunal rejects or pays only lip service to NPM clauses in BITs, it would imply that the state in question contracted to renounce its right to exist. The fundamental purpose of every state is to maintain law and order.

7. CONCLUDING REMARKS

For better or for worse, the Argentina cases have an unrivalled significance for the future of investor-state arbitration. I have argued that the Argentina cases raise important legal and doctrinal questions about the regime of BITs and the ICSID institution. These questions stem mostly from investors' professed rights versus the host state's authority to respond during a financial economic crisis for national interest. Are arbitrators bound to balance the rights in BITs against the state's power to safeguard public interests? At best, the Argentina cases have been inconsistent, so contradictory that one may wonder where ICSID stands. Does it give customary international law a higher value than treaty law or, better still, is the institution more prone to forgive or punish a state which, because of a financial economic crisis beyond its control, fails to meet international obligations?

One way to appreciate the differences between *CMS* and *LG&E* is their allocation of the burden of proof with regard to the defence of necessity. The *CMS* tribunal held that the burden rested on the host state, the *LG&E* tribunal on the claimant.⁹⁵ I prefer the latter. First, the *CMS* tribunal put the burden of proof on the host state while denying it the right to be the judge of the emergency of the crisis. It affirmed that art.XI of the BIT requires a substantive review to ascertain whether the emergency meets the conditions laid down in the treaty provisions.⁹⁶ But the tribunal never undertook such a substantive review. Even if it had, it would hardly be in good taste. The *CMS* tribunal "denied any margin of appreciation to the host state when it comes to choosing reactions to a state of emergency".⁹⁷ The justification for recognising the state's right to make that judgment is,

"because of their direct knowledge of their society and its needs, the national authorities are in principle better placed than the international judge to appreciate what is in the public interest".⁹⁸

Secondly, the "burden of proof has to fall on the party invoking the exception".⁹⁹ It is the state whose essential public interests are affected which needs to make the initial assessment and then take appropriate measures, and it is of this assessment that the tribunal would need to make an evaluation. The *CMS* tribunal without elaborating found Argentina to have

⁹² *S.S. Wimbledon (Britain, France & Japan V. Germany)* (1923) 1 P.C.I.J. 37.

⁹³ Chantal Thomas, "Competing Cultures of Law and Development in Investor-state Disputes" in *The American Society of Comparative Law* (2007), Annual meeting, Panel IV abstract, p.2.

⁹⁴ See Gabriel Bottini, "Protection of Essential Interests", 145.

⁹⁵ S.W. Schill, "International Investment Law" (2007) 24 *Journal of International Arbitration* 278, 278.

⁹⁶ *CMS* Case No.ARB/01/8 ICSID (2005) at [374].

⁹⁷ S.W. Schill, "International Investment Law" (2007) 24 *Journal of International Arbitration* 278, 281

⁹⁸ Gabriel Bottini, "Protection of Essential Interests", 162.

⁹⁹ S.W. Schill, "International Investment Law" (2007) 24 *Journal of International Arbitration* 278, 280.

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contributed to the economic crisis and that it had other alternatives to respond to it. It is obvious that the tribunal reached this conclusion only after putting the burden of proof of both elements on the host state. Fair play commands that the one who alleges guilty conduct should be the one to prove it. *LG&E* took this line of reasoning and concluded that the BIT emergency provision is only justified when measures are essential for safeguarding public essential interests:

“[T]he burden of proof relating to the existence of alternative, less restrictive measures and with respect to the contribution of the host state to the crisis rested upon the investor.”¹⁰⁰

One of the sharpest criticisms of evoking exceptional circumstances and related defences has been that:

“International law would be merely an empty phrase if it is sufficient for a state to invoke the public interest in order to evade the fulfillment of its engagements.”¹⁰¹

But for the Argentine crisis the *CMS* ruling was a harsh decision. It failed to take into account the hardship of ordinary citizens and the potential collapse of the state. The defence of necessity is an inevitable corollary to the concept of self-preservation. States have the fundamental right to exist and the consequent right of self-preservation.¹⁰² The sole purpose of the emergency legislation, the argument that was advanced by Argentina, was to bring “under control the chaotic situation that would have followed the economic and social collapse that Argentina was facing”¹⁰³ and not to expropriate the investors. On this fact at least, both *CMS* and *LG&E* tribunals found for Argentina and each dismissed the claim that the emergency legislation amounted to expropriation or indirect taking, since the investors retained the control and ownership of their investments.¹⁰⁴ Article 25(2)(b) of the ILC Articles disentitles a state from relying on the customary international law defence of necessity where the state itself substantially contributed to the crisis.

In an effort to classify ICSID and consequently BITs as instruments of economic hegemony, I have used two contradictory decisions by the *CMS* and *LG&E* tribunals. By their ad hoc nature, ICSID tribunals are expected to dissolve after each ruling. Their decisions are technically not even appealable. This not only gives ICSID an “imperial” voice but enables errors of law and fact to become established as the way forward. For the most part, I have subscribed to the reasoning in *LG&E*, because it accorded Argentina partial relief based on the defence of necessity for the period when it was in a state of peril. There is no denying the fact that Argentina damaged many foreign investors by altering their expectations through legislation. Even *LG&E* formally took notice of this fact in order to establish that Argentina had violated the Fair and Equitable Treatment standard.¹⁰⁵ The tribunal was careful to observe that a period of crisis cannot condone a

¹⁰⁰ *LG&E* Case No.ARB/02/01 ICSID (2006) at [242]; S.W. Schill, “International Investment Law” (2007) 24 *Journal of International Arbitration* 278, 280.

¹⁰¹ *Oscar Chin Case (Britain v. Belgium)* (1934) 63 P.C.I.J. (Ser.A/B) 112, cf. Roberto Aguirre Luzi, “BITs and Economic Crises” in Todd Weiter (ed.), *Investment Treaty Arbitration and International Law* (Huntingdon, NY: Juris, 2008), Vol.1, p.165; Michael Waibel, “Two Worlds of Necessity” (2007) 20 *Leiden Journal of International Law* 637, 637.

¹⁰² A.S. Hershey, *The Essentials of International Public Law and Organization*, revised edn (New York: Macmillan, 1927), p.231.

¹⁰³ *CMS* Case No.ARB/01/8 ICSID (2005) at [305].

¹⁰⁴ *CMS* Case No.ARB/01/8 ICSID (2005) at [263], *LG&E* Case No.ARB/02/01 ICSID (2006) at [200].

¹⁰⁵ *LG&E* Case No.ARB/02/01 ICSID (2006) at [124].

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violation of fair and equitable treatment: “Argentina went too far by completely dismantling the very legal framework constructed to attract investors.”¹⁰⁶ Although ICSID’s awards are limited to the cases at hand, we have witnessed a consistent pattern of reasoning along the lines of *CMS: Sempra* (2007), *Enron* (2007) and *Continental Casualty* (2008). Thus, even though ICSID awards are not supposed to create precedent, in practice they have persuasive authority:

“The danger of this approach is probably that it remains forever susceptible to challenge from voices from outside to an extent that it will disrupt substantially the direction of investment law for the future.”¹⁰⁷

Despite the good sense of the *LG&E* tribunal, its reasoning may unfortunately be perceived as an aberration rather than persuasive authority.¹⁰⁸

I have vigorously pointed to the contradictions in the two prominent rulings (*CMS* and *LG&E*). It is important to point out that one arbitrator did participate in both cases.¹⁰⁹ It is hard to comprehend how he could so easily change his mind in the two cases without further explanation on whether Argentina was entitled to take advantage of the defence of necessity in the face of a grievous economic crisis. One explanation can be that since the doctrine of *stare decisis* does not exist in international investment law, it follows that “arbitral tribunals are free to adopt rulings that deviate from prior decisions of other tribunals”.¹¹⁰ Another explanation could be that this inconsistency was about aspiring to seal arbitral harmony. Whatever be the case, I have been flabbergasted with the resolve of the *CMS* tribunal to pay only lip service to the economic hardships experienced by ordinary Argentines. It seems more to me that the arbitrator in the two tribunals did some soul searching after the *CMS* ruling, and sought to make significant amends on the loopholes of that award in *LG&E*. Putting the whole operation of the cases against Argentina into perspective, especially those that have rejected the customary international law defence of necessity, it may be that in most of these cases the tribunals have tended to see themselves as protectors of investors’ rights (central mission of the BIT system) despite the high political stakes, instead of standing as guarantors of justice.

¹⁰⁶ *LG&E* Case No.ARB/02/01 ICSID (2006) at [139].

¹⁰⁷ See David Schneiderman, “Judicial Politics and International Investment Arbitration: Seeking an Explanation for Conflicting Outcomes” in *ExpressO*, 2008, p.21. Available online: http://works.bepress.com/david_schneiderman/1 [Accessed November 23, 2009].

¹⁰⁸ Schneiderman, “Judicial Politics and International Investment Arbitration” in *ExpressO*, 2008, p.3. Of the finalised cases, two have so far somehow accepted Argentina’s “necessity” defence (*LG&E* Case No.ARB/02/01 ICSID (2006) and *Continental Casualty* (see now ICSID Case No.ARB/03/09) and three others have outrightly rejected it (*CMS* Case No.ARB/01/8 ICSID (2005), *Enron* Case No.ARB/01/3 ICSID (2007) and *Sempra* Case No.ARB/02/16 ICSID (2007)).

¹⁰⁹ Judge Francisco Rezek participated in both *CMS* Case No.ARB/01/8 ICSID (2005) and *LG&E* Case No.ARB/02/01 ICSID (2006) appointed by Argentina.

¹¹⁰ See Stephen W. Schill, “International Investment Law” (2007) 24 *Journal of International Arbitration* 278, 278.