2011

The Sovereign Debtor's Prison: Analysis of the Argentine Crisis Arbitrations and the Implications for Investment Treaty Law

Robert M. Ziff

American University, robert.ziff@gmail.com

Follow this and additional works at: http://scholarship.richmond.edu/global

Part of the Banking and Finance Law Commons, and the Comparative and Foreign Law Commons

Recommended Citation


Available at: http://scholarship.richmond.edu/global/vol10/iss3/4

This Article is brought to you for free and open access by the Law School Journals at UR Scholarship Repository. It has been accepted for inclusion in Richmond Journal of Global Law & Business by an authorized administrator of UR Scholarship Repository. For more information, please contact scholarshiprepository@richmond.edu.
THE SOVEREIGN DEBTOR'S PRISON:
ANALYSIS OF THE ARGENTINE CRISIS
ARBITRATIONS AND THE IMPLICATIONS
FOR INVESTMENT TREATY LAW

By Robert M. Ziff*

ABSTRACT

Over the last six years, several arbitration panels have released opinions in a series of disputes raised by investors against Argentina. In each case, foreign investors claim that Argentina's use of price controls and currency devaluation following the 2002 economic crisis constituted a violation of bilateral investment treaty obligations. Despite the fact that most claimants make identical allegations, many of these decisions are highly contradictory. In some cases Argentina is absolved of liability, while in others Argentina is held liable for hundreds of millions in damages. In aggregate, the claimants seek enough money to bankrupt the Argentine Republic.

Arbitral decisions that hold Argentina liable misinterpret both investment treaty law and customary international law. In essence, BITs are designed to resolve ad hoc disputes in which a state has taken improper action towards a particular investor. They are not designed to serve as an insurance policy when a macroeconomic crisis – and the necessary state intervention that follows – adversely affects foreign investors as a class. Instead, customary international law indicates that the parties should renegotiate in light of current economic realities.

TABLE OF CONTENTS

INTRODUCTION .................................................. 346
PART I. OVERVIEW OF THE ARGENTINE FINANCIAL CRISIS
ARBITRATIONS .................................................. 349
1.1 Argentine Economic History: A Case Study in
Crisis .......................................................... 349
1.2 The Published Opinions .................................. 352

* LL.M., London School of Economics; J.D., American University. For comments or questions, please contact via robert.ziff@gmail.com. I gratefully acknowledge the assistance of faculty and fellow students at the London School of Economics. The opinions expressed herein are my own.
1.3 The Fundamental Question: Are States Liable for Necessary Reforms? ....................... 354

PART II. ECONOMIC PRACTICALITIES: THE CYCLE OF MANIA AND CRISIS ........................ 355

PART III. UNLIMITED PROTECTION OF PRIVATE PROPERTY: THE SOVEREIGN DEBTOR'S PRISON .... 358

3.1 The Fair and Equitable Treatment Standard .......................... 358

3.1.1 Defined .................................. 359

3.1.2 Critique as Applied to Economic Crises ....... 361

3.1.3 Minority Voices .................................. 363

3.2 Other BIT Guarantees Similarly Restrict the State's Regulatory Power ..................... 364

3.3 Standard BIT Protections Encourage the State To Abstain From Legal Reform Even Where the Need for Reform is Extreme ..................... 365

3.4 The Necessity Defense .................................. 366

3.4.1 Confusion Between the NPM clause and Article 25 .................................. 366

3.4.2 Implications of Multiple Unique Standards . 368

3.4.3 Economic Necessity Under Article 25 ......... 369

PART IV: IMPLICATIONS AND RECOMMENDATIONS ..................... 375

4.1 Implications of the Dominant Jurisprudence ..... 375

4.1.1 Tension Between Necessary Reform and Potential Liability .................................. 375

4.1.2 Moral Hazard .................................. 377

4.1.3 Long-Term Consequences ..................... 377

4.2 Recommendations .................................. 378

CONCLUSION .................................................. 382

APPENDIX .................................................. 384

INTRODUCTION

On July 30, 2010, three arbitral opinions were released in an ongoing controversy between Argentina and numerous foreign investors who lost billions of dollars amidst the Argentine financial crisis in 2002. These awards – issued by ad hoc tribunals analyzing a nearly identical set of facts – are contradictory. Ad hoc tribunals found Argentina liable in two instances.\(^1\) But in the third instance, Argentina

was relieved of liability. This would be surprising but for the fact that fourteen opinions have been written on the subject and many of them are contradictory.

Investors have asserted claims under bilateral investment treaties ("BITs") that Argentina negotiated with capital exporting states (the U.S., the U.K., Spain, Italy, et cetera) in order to encourage foreign direct investment ("FDI"). The treaties form part of a larger infrastructure of BITs – over 2000 treaties between 170 states – that protect foreign investment from inappropriate government action. No two BITs are identical, but most grant the same basic guarantees to foreign investors. Typically, each state guarantees that it will (a) grant national and most favored nation ("MFN") treatment for investments, (b) pay compensation for expropriation, (c) abstain from arbitrary or discriminatory measures, and (d) show fair and equitable treatment. Should the state violate any of these guarantees, the investor can initiate an international arbitration claim against the state. Claims are administered by either the International Centre for the Settlement of Investment Disputes ("ICSID") or an alternate commercial arbitration body under the United Nations Commission on International Trade Law ("UNCITRAL") Arbitration Rules. Appellate rights are limited, though the ICSID system does provide for a second ad hoc annulment committee to review for manifest excess of powers.


5 Id. at 273-74

6 Id. at 173.

7 Id. at 119.


Though the system is technically bilateral, it is best described as imperfectly multilateral.

Theoretically, investment arbitration provides both investors and states with a reasonable and depoliticized means to resolve individual disputes. Accordingly, it operates similar to traditional international commercial arbitration. But, for Argentina, something unexpected has occurred. Amidst a massive economic crisis in which the state defaulted on US $100 billion in debt and enacted emergency reforms to its monetary policy, foreign investors lost immense sums of money. Investors – who had invested billions of dollars in Argentine bonds and privatized industry – felt that Argentina violated its treaty obligations. In response, these investors initiated the largest number of BIT claims ever raised against a single state. Argentina maintained that liability must be excused by the state of economic emergency. Tribunals are deeply split on the matter, frequently seesawing back and forth as to whether or not Argentina is liable.

As a rapidly evolving specialty of international law, new arbitral awards significantly influence the development of law. Furthermore, the circumstances under which Argentina finds itself are not unique. While Argentina has a famous history of economic crises, all states are subject to the same economic cycle. When crisis occurs, state economies are generally marked by tremendous instability, which compels governments to enact reform. Sovereign default is also common, especially among developing countries. Consequently, the claims against Argentina are relevant to all states that participate in the BIT system, not just Argentina. Indeed, every state that participates in the BIT system must know the answer to one question: To the extent that states guarantee a stable climate for FDI, should they be held liable for significant legal reforms that are made as a rational, good-faith, and potentially necessary response to an economic crisis? If the answer is yes, then arbitration claims against an insolvent state transform the BIT system into something like an international insolvency regime. This is because claimants are likely to demand restitution in excess of what the state can pay. Some commentators have

---

13 See generally Carmen M. Reinhart & Kenneth S. Rogoff, This Time Is Different 33 (2009); Economic and Financial Crises in Emerging Market Economies (Martin Feldstein, ed. 2003); Padma Desai, Financial Crisis, Contagion, and Containment: From Asia to Argentina (2003).
raised red flags, suggesting that this line of jurisprudence could lead to a wave of claims against many states at a time when they are least capable of managing added liability.\footnote{14} While such theories remain unproven, the legal analysis is sound. If this disturbing line of jurisprudence is followed to its logical end, states may be condemned to what this article calls “the sovereign debtor’s prison” – an inefficient process of ad hoc arbitrations that subjects sovereign states to immense liability without limitation at a time when they are in greatest need of debt relief.

This article analyzes how (a) the sovereign debtor’s prison has developed through incremental jurisprudence; (b) that jurisprudence conflicts with basic aspects of the economic cycle; and (c) tribunals can reach a more just resolution to these claims. Part I describes the context of these disputes by summarizing the Argentine crisis of 2002 and the opinions released to date. Part II describes how financial crises are pro-cyclical and create long-term negative consequences. Part III explains how the sovereign debtor’s prison is built upon a disconnect between unlimited BIT liability and the pressing need for states to regulate amidst a crisis. Part IV describes the implications of this jurisprudence and recommends that investment tribunals should consider the greater implications of their awards in order to reach a more just solution. The article concludes that the failure to consider these greater implications will undermine the existing BIT structure by frustrating the intention of the states that ratify these treaties.

\section{Part I. Overview of the Argentine Financial Crisis Arbitrations}

\subsection{Argentine Economic History: A Case Study in Crisis}

At the dawn of the twentieth century, Argentina was one of the ten richest nations in the world.\footnote{15} Fueled by strong agricultural exports, growth averaged six to seven percent \textit{per annum}.\footnote{16} But over the next sixty years, a series of “economic and political convulsions” crushed the nation’s early prosperity.\footnote{17} This period was marked by high protective tariffs, a closed state-controlled economy that encouraged corruption, fiscal irresponsibility, high inflation, and political instability.\footnote{18} To arrest the startling rate of inflation, the government

\footnote{15} Blustein, supra note 10, at 16.
\footnote{16} \textit{Id.} at 16.
\footnote{17} \textit{Id.} at 17.
\footnote{18} \textit{Id.} at 17-18.
initiated no less than seven stabilization programs based upon on a fixed exchange rate with promises of fiscal austerity. All of these programs failed and resulted in currency devaluation.\textsuperscript{19} By the late 1980s, Argentina was in the grips of long-term hyperinflation peaking at a rate of 3,079.5\% per annum in 1989.\textsuperscript{20} One arbitral tribunal has correctly noted that Argentina's economy was more likely to be in crisis than out.\textsuperscript{21}

In this cycle of crisis and rebirth, the government established "Convertibility" and engaged in a herculean effort to encourage FDI through a mixture of guarantees and privatization of state-run industries.\textsuperscript{22} Under the policy of Convertibility, Argentina "established a hard nominal peg" between the peso and the U.S. dollar at a rate of 1:1.\textsuperscript{23} State-run industries – e.g. oil, electricity, and telecommunications – were privatized.\textsuperscript{24} FDI was considered an essential aspect of the privatization system, so the government made a series of guarantees to potential foreign investors. Some promises, like Convertibility, were general in nature. Other policies were more specific. With respect to the gas industry, for example, the government effectively guaranteed investors a stable stream of tariffs denominated in U.S. dollars and adjusted according to U.S. Inflation indices.\textsuperscript{25} Simultaneously, the government negotiated BITs with capital exporting states.\textsuperscript{26} Throughout the 1990s, the Argentine government upheld its guarantees and the economy grew at an impressive rate. Inflation reduced to


\textsuperscript{20} See Reinhart & Rogoff, supra note 13, at 186.

\textsuperscript{21} LG&E Energy Corp. v. Argentine Republic, Decision on Liability, ICSID (W. Bank) Case No. ARB/02/1 (Oct. 3, 2006), 21 ICSID Rev.-F.I.L.J. 203 (2006), ¶ 228 [hereinafter LG&E Decision on Liability] ("Indeed, the country has issued a record number of decrees since 1901, accounting for the fact that the emergency periods in Argentina have been longer than the non-emergency periods."). \textit{available at} http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal =showDoc&docld=DC625\_En&caseId=C208.


\textsuperscript{23} Id.

\textsuperscript{24} Id.

\textsuperscript{25} See Enron Corp. v. Argentine Republic, Award, ICSID (W. Bank) Case No. ARB/01/3, ¶¶ 41-46 (May 22, 2007) [hereinafter Enron Award], \textit{available at} http://ita.law.uvic.ca/documents/Enron-Award.pdf.

nominal levels. The budget deficit dropped to less than one percent of GDP. Argentina received over $100 billion in net capital inflows and over $60 billion in gross FDI.\textsuperscript{27} It became the poster child of the “Washington Consensus” – a list of economic principles promoted by the IMF and World Bank that emphasized privatization of industry, deregulation of the economy, and protection of private property.\textsuperscript{28} However, shortly thereafter, a combination of external shocks and internal structural deficiencies created a vicious economic cycle. Devaluation of the Brazilian real, a strengthening U.S. dollar (which dragged the peso up with it), a sharp reduction in capital flows to emerging markets globally, a rise in international interest rates, and a drop in commodities prices combined with widespread tax evasion, an inflexible labor market, and an inflexible government budgeting process collectively and rapidly destroyed the Argentine economy.\textsuperscript{29} Growth decelerated rapidly, negatively impacting already stressed government finances. The government’s strict monetary policy, Convertibility, prevented it from devaluing its currency while enabling capital flight. The poverty level doubled to 54.3% of the urban population. Violent demonstrations, riots, and looting erupted. A political vacuum formed in which a series of presidents resigned in a matter of days.\textsuperscript{30} Ultimately, the government was forced to abandon Convertibility and defaulted on over US $100 billion in debt as it faced the prospect of total insolvency. Once the peso began to float on the open market, it rapidly fell to less than US $0.25 per peso. To prevent significant added hardship, the government converted all dollar-denominated debt and utility tariffs within the country into pesos at the rate of 1:1 – so-called “pesofication” of the economy.\textsuperscript{31} Companies who believed their revenue was guaranteed in U.S. dollars suddenly found their revenue reduced dramatically.\textsuperscript{32} These companies, which had financed their investments in dollars on the international markets, soon defaulted on their loans.\textsuperscript{33} The government’s decision to adopt “pesofication” and default on its debt – despite numerous prior guarantees to the contrary

\textsuperscript{27} See IMF Independent Evaluation Report, supra note 22, at 11.
\textsuperscript{28} See Blustein, supra note 10, at 4.
\textsuperscript{30} See IMF Independent Evaluation Report, supra note 22, at 11-16.
\textsuperscript{31} See id. at 13.
\textsuperscript{33} See, e.g., id., at ¶ 64.
are now the subject of the largest number of BIT claims raised against any government to date.\textsuperscript{34}

1.2 – The Published Opinions

The claimants have universally asserted (1) expropriation of investment, (2) violation of the umbrella clause, and (3) violation of the fair and equitable treatment standard. All of the BIT claims relate to Argentina’s default and its abandonment of Convertibility. In its response, Argentina has raised two affirmative defenses: (a) non-violation pursuant to the non-precluded measures (“NPM”) clause found in the US-Argentina BIT\textsuperscript{35} and (b) necessity pursuant to Article 25 of Draft Articles on the Responsibility of States for Internationally Wrongful Acts (“Draft Articles”).\textsuperscript{36} Nine cases have reached some stage of conclusion regarding liability. Billions of dollars have already been awarded to various claimants, though two of the larger claims were subsequently annulled.\textsuperscript{37}

\textsuperscript{34} See UNCTAD Developments in Dispute Settlement, supra note 11, at 3 (“Overall, Argentina still tops the list with 48 claims lodged against it.”).

\textsuperscript{35} See US-Argentina BIT, supra note 26, Art. XI.


The Appendix summarizes the outcome of the decided claims to date.\(^\text{38}\) Chart 1 organizes the claims into three groups based upon two separate criteria — similarity of BIT provisions and similarity of claims. Claimants listed under Groups 1 and 2 are all similarly regulated utility companies (gas transportation/distribution, electrical power, or municipal water supply) whose factual allegations are nearly identical. Group 1 claimants are U.S. nationals. These nationals fall under the US-Argentina BIT, which contains a Non-Precluded Measures Clause ("NPM").\(^\text{39}\) Group 2 claimants are western European nationals and fall under BITs signed with the UK, France, and Spain. Since none of these treaties contain an NPM clause, Argentina can only argue customary necessity under the Draft Articles as a defense. (As will be shown later, relying upon the customary standard alone is more difficult).\(^\text{40}\) Group 3 is composed of a single case, *Continental Casualty*. This case must be distinguished from Groups 1 and 2 because it relies solely upon the Convertibility regime as a source of rights while the other claims rely upon express guarantees that Argentina made to privatized utility companies. Chart 2 lists the relevant publicly available opinions in chronological order.

A cursory review of these decisions reveals two significant factors. Chart 1 reveals the near-universal agreement that Argentina violated the fair and equitable treatment standard. Argentina’s emergency reform measures — which devalued the currency, froze public utility tariffs, and otherwise radically altered the business environment — altered the legal environment that foreign investors had relied upon. Furthermore, several tribunals found that Argentina also violated its obligations under the umbrella clause by violating express guarantees made to certain investors. Consequently, almost all tribunals agree Argentina violated basic obligations of investment treaty law.

There is, however, no consensus with regard to the necessity defense. Altogether, twelve three-member panels have considered the issue; seven tribunals rejected the necessity defense, two tribunals accepted the defense, and three ICSID annulment committees indicated support for Argentina’s defense. Given the small sample size and the fact that several arbitrators sit on multiple tribunals,\(^\text{41}\) a simple comparison of yeas and nays reveals nothing. A chronological analysis is

\(^{38}\) *See infra* Appendix.

\(^{39}\) US-Argentina BIT, *supra* note 26, at Art. XI.

\(^{40}\) *See infra* Part 3.4.1.

\(^{41}\) The same arbitrator presided as president of the *CMS Gas*, *Enron*, and *Sempra Energy* tribunals and the final opinions are remarkably similar. Additionally, the *Vivendi/AWG Group* and *InterAgua* decisions were decided by identical tribunals. Thus, what appears to be five unique opinions is actually just two.
also of little value. Chart 2 reveals that decisions are regularly released going both ways on the issue; thus, there is no movement toward a specific position.

1.3 – The Fundamental Question: Are States Liable for Necessary Reforms?

While Argentina’s economic policy was less than ideal, the historical record shows that the principal public officials acted in good faith.42 Before the crisis peaked, Argentina attempted to maintain Convertibility while paying off its sovereign debt by engaging in an intense austerity plan that severely affected its own population. When the austerity measures failed to prevent massive capital flight, the government had no choice but to break Convertibility and legislative forced pesification of the economy in order to prevent total insolvency. In other words, Argentina experienced a balance of payments crisis, which often occurs when states establish a fixed foreign exchange rate.43

Financial crises arise in many forms, of which a balance of payments crisis is one. As Reinhart and Rogoff’s recent work, *This Time is Different*, makes abundantly clear, “[F]inancial crises follow a rhythm of boom and bust through the ages. Countries, institutions, and financial instruments may change across time, but human nature does not.”44 Accordingly, a single question of law permeates all of the claims against Argentina: *To the extent that states guarantee a stable climate for foreign direct investment, should they be held liable for significant legal reforms that are made as a rational, good-faith, and potentially necessary response to an economic crisis?*

If the answer is yes i.e., if BIT arbitration is utilized to assign liability in the midst of a financial crisis, the results may be staggering. The pending claims against Argentina are valued at multiple billions of dollars, well beyond what Argentina could pay.45 Thus, the

42 See *Sempra Energy Award*, supra note 37, at ¶ 304.
43 *Paul Krugman & Maurice Obstfeld, International Economics: Theory and Policy*, 460-461 (7th ed. 2006) (“In many practical situations . . . the central bank may find it undesirable or infeasible to maintain the current fixed exchange rate. The central bank may be running short on foreign reserves, for example, as happened to many developing countries in the 1990s and 2000s, or it may face high domestic unemployment. Because market participants know the central bank may respond to such situations by devaluing the currency, it would be unreasonable for them to expect the current exchange rate to be maintained forever.”).
44 Reinhart & Rogoff, supra note 13, at xxviii.
system transforms into an international sovereign bankruptcy code devoid of efficient procedures or guidelines for handling it.

PART II. ECONOMIC PRACTICALITIES: THE CYCLE OF MANIA AND CRISIS

The developing jurisprudence related to the Argentine crisis could be dismissed as *sui generis* if the circumstances that led to the crisis were abnormal. However, the Argentine crisis was the latest in a wave of crises that began in East Asia and spread to Russia, Mexico, Turkey and Brazil before affecting the Argentine economy.\(^{46}\) Furthermore, it is part of a much larger cycle of crises recurring throughout history. Reinhart and Rogoff have analyzed hundreds of episodes in which sovereign states have defaulted on their external debt.\(^{47}\) According to their analysis, “there are long periods when a high percentage of all countries are in a state of default . . .”\(^{48}\) The ability to accurately predict or prevent such crises remains elusive. However, certain conclusions are sufficiently accepted by mainstream economists as to be useful for policy makers: (1) economic crises are simultaneously pro-cyclical and unpredictable; (2) crises create instability, which compels the government to intervene; (3) crises cause negative and/or low economic growth, which persists long after the “crisis” has passed; and (4) developing countries are particularly prone to crisis.

(1) **Crises are pro-cyclical and unpredictable.** Economic crises come in many forms: *inter alia* hyperinflation, currency crashes, bursting asset price bubbles, banking crises, external debt crises, and domestic debt crises. But before a crisis develops, the market is often in the grips of euphoria. A widely held belief that fundamental rules no longer apply permeates the market. Reinhart and Rogoff call it the “This Time is Different Syndrome.” This syndrome “is rooted in the firmly held belief that financial crises are things that happen to other people in other countries at other times; crises do not happen to us, here and now.”\(^{49}\) Kindelberger, in his seminal work *Manias, Panics & Crashes*, describes a similar phenomenon that he calls “mania”:

> The features of these manias are never identical and yet there is a similar pattern. The increase in prices of commodities or real estate or stocks is associated with eu-


\(^{47}\) Reinhart & Rogoff, supra note 13, at 51.

\(^{48}\) Id. at 68.

\(^{49}\) Id. at 15.
phoria; household wealth increases and so does spending. There is a sense of ‘We never had it so good.’

Amidst euphoria, market participants are blinded by their own false expectations; they cannot see their place in an asset bubble. With regard to the Argentine crisis, Blustein describes how “a fevered atmosphere for emerging markets had taken hold in the financial world, based on the belief that the fastest growth, quickest profits, and highest yields were to be found in former economic backwaters that were getting with the capitalist program.” Eventually, however, sellers outnumber buyers. Prices fall rapidly and panic ensues.

The cycle becomes apparent only when viewed in hindsight. Reinhart & Rogoff’s data reveal a recurrent pattern in which “serial default remains the norm” across the world and throughout history. Kindelberger relates the tales of countless crises. (2) Instability compels the state to act. The cycle—one of manias followed by panics—creates “pro-cyclical changes in the supply of credit; the credit supply increases relatively rapidly in good times, and then when economic growth slackens, the rate of growth of credit has often declined sharply.” The lack of credit creates hardship and the risk “that a deflationary panic [will] spread and wipe out sound investment by the non-speculators.” Though some economists argue against state intervention,

[T]he dominant argument against the a priori view that panics can be cured by being left alone is that they almost never are left alone . . . [i]n panic after panic, crash after crash, crisis after crisis, the authorities . . . try to halt the panic by one device or another.

(3) Economic crises entail long-term consequences to the economy as a whole. The countries that experienced crisis in the 1990s eventually rebounded, although the crisis continued to affect them for years afterwards. Growth rates, lending, and stock market indices remained below pre-crisis levels for years. Reinhart and Rogoff’s data confirm this phenomenon as characteristic of all crises. Output always falls dramatically while unemployment and government debt increases.

---

51 Blustein, supra note 10, at 30.
52 Id. at 3.
53 See Reinhart & Rogoff, supra note 13, at Figs. 5.1-5.2.
54 See generally Kindleberger & Aliber, supra note 50.
55 Id. at 10.
56 Id. at 178.
57 Id. at 181.
59 Reinhart & Rogoff, supra note 13, at 226-238.
“Fiscal finances suffer mightily as government revenues shrink in the aftermath of crises and bailout costs mount.”

If sovereign default occurs, it persists for an average of three years. Returning to pre-crisis levels of output takes an average of four years.

(4) Developing countries are particularly prone to crisis. Developing countries are more likely to suffer financial crisis and sovereign default. In particular, many developing countries are “serial defaulters” of sovereign debt. A variety of explanations exist for this phenomenon, suggesting that multiple structural weaknesses are involved. For instance, developing countries generally lack a robust and modernized financial system, which creates instability when they liberalize their economies to attract investment. In addition, fixed exchange rates and insufficient foreign currency reserves make developing countries more sensitive to crisis. Furthermore, they are particularly dependent upon financing from developed countries; therefore, a crisis in the economic “north” can spread rapidly to developing countries. Moreover, international markets lack confidence in developing countries’ ability to pay debt, creating debt intolerance – “the extreme duress many emerging markets experience at external debt levels that would seem quite manageable by the standards of advanced countries.”

Undoubtedly, there are other potential reasons.

A thorough analysis of economic crises is beyond the scope of this article. However, in the realm of investment treaty law, arbitrators need to be aware of the economic cycle because it has profound implications for the field. In particular, the fact that economic crises are unpredictable, pro-cyclical, and destabilizing should give any arbitrator pause before laying an extra several billion in debt on already struggling populations.

---

60 Id. at 289.
61 Id. at 80.
62 Id. at 236.
63 Id. at 89-100.
65 Economic and Financial Crises in Emerging Market Economies, supra note 46, at 4, 10.
66 Reinhart & Rogoff, supra note 13, at 74.
PART III. UNLIMITED PROTECTION OF PRIVATE PROPERTY: THE SOVEREIGN DEBTOR'S PRISON

In light of the recurrent and long-term negative consequences of economic crises described in Part II, sovereign debtors may need an organized and efficient structure that permits them to default and resolve their international debts efficiently. The IMF has suggested such a system in the past, prompting some academics to consider a possible structure.  

With regard to sovereign bonds, many now include Collective Action Clauses (“CAC”)s that enable negotiations between the state and all bondholders simultaneously after default occurs. The BIT system, however, is not designed to accomplish an efficient distribution of assets. The guarantees contained in these treaties protect individual private property claims without regard to the interests of other claimants.

Given the infancy of investment treaty law, many questions remain unanswered. How far does the protection of property extend? For instance, should liability extend to claims against insolvent states? It seems no authoritative source contemplated this question before the BIT system expanded in the latter half of the twentieth century. Due to conflicting jurisprudence, the question has no definitive answer. However, BIT standards are designed to operate as a counterweight against populist anger (more common in democracies) and arbitrary decision-making (more common in authoritarian regimes) that often precipitate in times of stress. This is certainly true with respect to three standards that implicate the state’s regulatory authority – the fair and equitable treatment standard, the umbrella clause, and the (indirect) expropriation clause. On this foundation, the sovereign debtor’s prison is built.

3.1 – Fair and Equitable Treatment: Respecting the Investor’s Expectations to the Exclusion of Other Values

There is “no general agreement on the precise meaning” of the fair and equitable treatment standard. BITs rarely define it and “[t]he ‘ordinary meaning’ of the ‘fair and equitable treatment’ standard

---

can only be defined by terms of almost equal vagueness."71 Nevertheless, the fair and equitable treatment standard remains an integral guarantee of all investment treaties. It is always invoked by complaining investors and remains the most likely claim to succeed on the merits.72

3.1.1 – Fair and Equitable Treatment Defined

The dominant position in investment treaty law holds that "fair and equitable treatment" is a broadly applicable and objective standard of behavior. States must comply with certain standards of behavior including (a) transparency, (b) consistency, (c) compliance with contractual obligations, (d) procedural and proprietary due process, (e) good faith, (f) absence of coercion or harassment, and (g) stability of the legal and business framework and protection of the investor's reasonable expectations.73 That the standard has come to mean so much (a broad duty to respect investor expectations and refrain from altering key provisions of the law) from so little (the words "fair and equitable") is due to three factors. First, the fair and equitable treatment clause is a gap-filling measure designed to censure all "inappropriate" behavior.74 Second, the vague language employed "easily lends itself to an expansive view of its reach extending to all corners and aspects of an investment setting."75 Third, and perhaps most important, an ever-increasing body of arbitral opinions continues to broaden the standard.

Although each investment tribunal is formally ad hoc and therefore without precedential value, in practice, tribunals recognize an "informal, but powerful system of precedent . . ."76 Ten years after the Metalclad77 award first defined fair and equitable treatment, the

---

71 Saluka Investments BV v. Czech Republic, Partial Award, ¶ 297 (March 17, 2006) (UNCITRAL Arbitration); see Enron Award, supra note 25, at ¶ 256 ("[F]air and equitable treatment is a standard none too clear and precise."); LG&E Decision on Liability, supra note 12, at ¶ 122 (noting the standard is not defined by the treaty).
72 UNCTAD Developments in Dispute Settlement, supra note 11, at 8.
74 Id. at 122.
76 See Cheng, supra note 12, at 1016.
77 Metalclad Corp. v. United Mexican States, Award, ICSID (W. Bank) Case No. ARB(AF)/97/1, 5 ICSID Rep. 209 (Aug. 30, 2000).
concept has begun to solidify.\textsuperscript{78} In doing so, tribunals have created an increasingly large body of jurisprudence that defines the fair and equitable treatment standard in a manner that emphasizes protection of the investor with little regard to the regulatory responsibility of the state.

Consider, for example, the state’s obligation to maintain a stable legal environment and protect the investor’s reasonable expectations. Under this obligation, a state’s liability is judged by a three factor test: (1) the investor must form a legitimate expectation based upon the state’s laws or via direct dealings with the state; (2) the investor must rely upon such expectations in making its investment; and (3) a sudden change in the laws or treatment by the government must frustrate the investor’s expectations.\textsuperscript{79} In Argentina’s case, the state made various promises to the foreign investment community regarding the legal environment, sometimes including guaranteed increases in revenue.\textsuperscript{80} In reliance upon these promises, the investors borrowed heavily from international markets in order to invest in Argentina. But when the financial crisis reached its apex, Argentina eroded Convertibility and violated important guarantees. The investors, who suddenly received devalued pesos while attempting to maintain debt that remained valued in US dollars, defaulted on their loans. As such, the investors formed “reasonable” expectations based upon the state’s guarantees of increased revenue, relied upon those guarantees to finance their investments, and suffered immense losses when the state violated those guarantees. Consequently, almost every tribunal has determined that Argentina violated the fair and equitable treatment standard.\textsuperscript{81}

The \textit{Enron} Award summarizes the matter in a characteristic fashion:

267 . . . It is clear that the stable legal framework that induced the investment is no longer in place and that a definitive framework has not been made available for almost five years.

268. Even assuming that the Respondent was guided by the best of intentions, which the tribunal has no reason to doubt, there is here an objective breach of the fair and equitable treatment due under the treaty . . . \textsuperscript{82}

\textsuperscript{78} \textit{Id.} \textit{See, e.g.}, \textit{LG&E} Decision on Liability, \textit{supra} note 21, ¶ 125 ("[T]he tribunal considers this interpretation to be an emerging standard of fair and equitable treatment in international law.").

\textsuperscript{79} \textit{See InterAgua} Decision on Liability, \textit{supra} note 1, ¶¶ 202-207.

\textsuperscript{80} \textit{Id.}

\textsuperscript{81} The issue is complicated by the \textit{Continental Casualty} Award, whose reasoning is unclear. \textit{See Continental Casualty Award, supra} note 37, ¶¶ 254-266.

\textsuperscript{82} \textit{Enron Award, supra} note 25, ¶¶ 267-268.
3.1.2 – Critique of Fair and Equitable Treatment as Applied to Economic Crises

According to this logic, "fair and equitable treatment" is synonymous with *pacta sunt servanda*. Why this should be the case is not intuitively obvious. Assuming the words "fair and equitable treatment" requires states to maintain a stable legal framework under periods of normal growth or even recession, the same deductive reasoning does not apply under extreme economic stress. Kingsbury and Schill make the point succinctly:

[T]he investor’s expectations about the State’s future conduct in ordinary circumstances can not necessarily be transposed into a ‘legitimate expectation’ about State action in extraordinary circumstances, and expectations ought in many cases to encompass the possibility that the State may take some regulatory actions. States are regulators with public responsibilities.83

Investors are certainly aware that an economic crisis can impact expected revenue. All investment involves risk, for which investors happily charge a premium. In some countries, the risks related to investment may be particularly high. Indeed, a small industry of respected analysts exist to determine the precise level of country-specific risk – which includes the risks of default, devaluation, inflation, and other factors that impact investor's expectations.84 Investors use these reports in order to determine the appropriate return on investment relative to the increased risk. Investors never rely solely on the state's guarantees; to do so would be irrational.


The Enron Award paid lip service to the notion that the claimant’s expectations must be “reasonable and justifiable.”\textsuperscript{85} However, the tribunal’s analysis is limited to determining whether the state made guarantees. It does not consider the reasonableness of the guarantees themselves. Herein lies the problem. In order for claimants to rely upon the fair and equitable treatment standard, they must establish that they had a reasonable expectation that Convertibility could be maintained. At the very least, they must establish that the risk of devaluation shifted from the investors to the state. Although it can be argued that Argentina made such guarantees, no reasonable investor could possibly have believed that Argentina would follow through in the event of a crisis. In fact, reasonable investors did not actually believe that these risks were eliminated. They calculated the added risk and demanded a commensurate higher return instead.\textsuperscript{86} If they had believed their investments were truly safe, then the rate of return on investment would have been much closer to the rate charged for similar investments in the United States where the risk of default is low.

Furthermore, it is unclear why investors had any reason to expect that Argentina could shoulder the cumulative weight of its guarantees. Before the crisis, “Argentina received more than $100 billion in net capital inflows, including over $60 billion in gross foreign direct investments.”\textsuperscript{87} Investors were undoubtedly aware of the piles of money flowing into the country. By way of comparison, Argentina’s total foreign currency reserves in June 2010 were just US $50 billion.\textsuperscript{88} Accordingly, there is no reason to believe that Argentina could possibly make good on such promises to investors after such a massive speculative bust.

Nevertheless, all but one tribunal takes the opposite approach. According to the National Grid Award, it is precisely because of Argentina’s prior crises that Argentina felt obliged to make such guarantees to investors: “[t]he Claimant made its investment at a time when, after a severe economic crisis, the Respondent was trying to offer a different

\textsuperscript{85} Enron Award, supra note 25, at ¶ 262; see also Int’l Thunderbird Gaming Corp. v. United Mexican States, Award, ¶¶ 147-48, Jan. 26, 2006 (UNCITRAL Arbitration), available at http://www.iisd.org/pdf/2006/itn_award.pdf,

\textsuperscript{86} See CMS Gas Award, supra note 37, at ¶¶ 184-85.

\textsuperscript{87} IMF INDEPENDENT EVALUATION REPORT, supra note 22, at 11.


Even if Argentina desired to pay off all investors with their foreign currency reserves currency reserves, such a move would likely prove highly destabilizing. Foreign currency reserves are essential to preventing currency crises. See Frederic S. Mishkin, Financial Policies and the Prevention of Financial Crises in Emerging market Countries, Economic and Financial Crises in Emerging market Economies 126-127 (Martin Feldstein, ed., 2003).
image to investors. Similarly, the InterAgua Decision on Liability noted, “[i]t was largely because of the country’s history of instability that the Claimants required the incorporation of the specific clauses on extraordinary tariff adjustment reviews mentioned above.” Consequently, the tribunal emphasized Argentina’s promise while ignoring its clear inability to perform in the event of a crisis. It furthermore ignores the fact that investors never fully accepted the state’s guarantees in the first place.

3.1.3 – Minority Voices

The strict interpretation of fair and equitable treatment is not universally accepted. Even amongst arbitrators, some voices of dissent exist. For instance, Duke Energy v. Ecuador suggested that an investor’s “reasonable expectations” depends upon all relevant circumstances:

To be protected, the investor’s expectations must be legitimate and reasonable at the time when the investor makes the investment. The assessment of the reasonableness or legitimacy must take into account all circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host State.

The Continental Casualty Award similarly criticized the dominant pro-investor interpretation of “fair and equitable treatment.” The award states, in dictum, that, “it would be unconscionable for a country to promise not to change its legislation as time and needs change, or even more to tie its hands by such a kind of stipulation in case a crisis of any type or origin arose.”

Most recently, Pedro Nikken – a former President of the Inter-American Court of Human Rights and one of Argentina’s appointed arbitrators – wrote a scathing separate opinion in the InterAgua and Vivendi/AWG decisions that was highly critical of the tribunal’s strict interpretation of “fair and equitable treatment.” According to Nikken, “[i]t is unreasonable to assume that the States would have been willing to commit themselves beyond what the canons of good governance would require.” Nevertheless, this is the minority perspective.

89 National Grid Award, supra note 32, at ¶ 176.
90 InterAgua Decision on Liability, supra note 1, at ¶ 214.
92 Continental Casualty Award, supra note 37, at ¶ 258.
3.2 – Other BIT Guarantees Similarly Restrict The State’s Regulatory Power.

Other BIT guarantees similarly compel states to freeze policy or face liability. Two standards in particular – the umbrella clause and the (indirect) expropriation clause – raise specific concerns.

A typical umbrella clause requires states to “observe any obligation it may have entered into with regard to investments.” Its function is to transform contract claims into treaty claims. The clause is simplistically short, but applying it consistently has proven difficult. Both tribunals and academics are unclear as to its meaning, inevitably leading to contradictory opinions.

This difficulty is evident in the claims against Argentina. Six opinions have considered whether Argentina violated the umbrella clause in light of the guarantees that it made to investors. Under identical facts and law, four tribunals found that Argentina violated umbrella clause guarantees. However, one tribunal reached the opposite conclusion; and an annulment committee determined that the tribunal’s finding of liability constituted annulable error.

Despite this inconsistency of opinion, some basic conclusions can be drawn. First, the umbrella clause blurs the distinction between contractual obligations and treaty obligations. Second, a liberal interpretation of the clause holds that any contractual commitment creates an obligation under the treaty. Where such obligations exist, liability can attach automatically. Unlike “fair and equitable treatment”, the umbrella clause is not limited by any kind of reasonableness analysis.

BIT protection against expropriation is more straightforward. Standard BITs provide that an investment may not be expropriated unless compensation equal to the fair market value is provided in return. The issue becomes complicated, however, where the claimant

95 See Sempra Energy Award, supra note 37, at ¶ 309 (describing the umbrella clause as a “mystery”).
96 See Dolzer & Schreuer, supra note 4, at 155 (“[T]he purpose, meaning, and scope of the clause have caused controversy and have given rise to disturbingly divergent lines of jurisprudence.”).
97 See Appendix, Chart 1.
98 See Dolzer & Schreuer, supra note 4, at 155; CMS Gas Award, supra note, at ¶¶ 296-303 (finding a violation of the umbrella clause due to a failure to respect stabilization clauses); but see CMS Gas Annullment Decision, supra note 37, at ¶¶ 89-100 (annulling the tribunal’s conclusion on this point).
100 See, e.g., US-Argentina BIT, supra note 26, at Art. IV(1).
alleges "creeping", "regulatory", and/or "indirect" expropriation. Generally speaking, such expropriation occurs where "interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State."\textsuperscript{101} Such interference generally involves a regulatory act of the state.

The difficult question is distinguishing the difference between a non-compensable regulatory act and a compensable act of expropriation. International law provides little definitive guidance in this matter.\textsuperscript{102} Expropriation is relevant here because it is implicated in one aspect of economic crises – sovereign default. Default is defined by the state’s failure to pay agreed compensation on its debt. Thus, it may be a regulatory expropriation because it deprives the owner of the investment’s reasonably expected economic benefit.\textsuperscript{103} In the case of Argentina, a conglomeration of over 195,000 Italian claimants with US$4.4 billion in defaulted Argentine government bonds have initiated an investment claim against Argentina.\textsuperscript{104} If they succeed on the merits, the award will have profound implications for the government’s finances.\textsuperscript{105}

3.3 – Standard BIT Protections Encourage the State to Abstain from Legal Reform Even Where the Need for Reform is Extreme.

The "fair and equitable treatment standard" – which threatens liability whenever the state engages in reform – encourages the state to freeze economic and regulatory policies. Where the umbrella clause applies, the state’s obligations become absolute. Furthermore, if a tribunal declares that a state is liable for defaulting on its debt (which seems likely) the obligation to pay compensation on expropriation may attach without limitation. Therefore, if the cumulative impact of these guarantees is considered as a whole, then regulatory power is wholly subject to the investor’s private property rights. The Sempra Energy Award reflects this understanding, albeit in decidedly diplomatic fashion:

A judicial determination as to compliance with the requirements of international law in this matter should

\textsuperscript{101} See Metalclad, supra note 77, at ¶ 103.
\textsuperscript{102} See Saluka, supra note 71, at ¶¶ 263-264; see also National Grid Award, supra note 32, at ¶ 148.
\textsuperscript{104} See Beccara Order, supra note 45.
\textsuperscript{105} See generally Michael Waibel, Opening Pandora’s Box: Sovereign Bonds in International Arbitration, 101 AMER. J. INT’L. L. 711 (2007).
not be understood as suggesting that arbitral tribunals wish to substitute their views for the functions of sovereign States. Such a ruling instead simply responds to the Tribunal's duty that, in applying international law, it cannot fail to give effect to legal commitments that are binding on the parties... 106

Consequently, standard BIT guarantees create negative incentives for government reform at a time of crisis. Economic crises entail significant instability, the impact of which can be extreme. 107 In Argentina, instability threatened to destabilize the state itself. However, investment treaties encourage the state to avoid reform, especially if the potential for liability is significant. Thus, in order for a state to act in times of need, investment treaty law requires a limiting doctrine.

3.4 – The Necessity Defense

The necessity doctrine actually involves two separate but overlapping defenses. The first derives from the Non-Precluded Measures (“NPM”) clause, found in some BITs (including the US-Argentina BIT). The second defense springs from the customary international law defense of necessity as embodied in Article 25 of the Draft Articles.

3.4.1 – Confusion Between the NPM Clause and Article 25

The NPM clause is a typical feature of BITs signed by certain major trading nations including the United States, Germany, and India. 108 Article XI of the US-Argentina BIT contains a relatively typical formulation of an NPM clause:

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. 109

The NPM clause “allow[s] states to take actions otherwise inconsistent with the treaty when, for example, the actions are necessary for the protection of essential security, the maintenance of public

106 Sempra Energy Award, supra note 37, at ¶ 389.
107 See supra Part II.
109 U.S.-Argentina BIT, supra note 23, at art. XI.
order, or to respond to a public health emergency."\textsuperscript{110} It is a primary rule of international law, which is to say that it addresses the question of compliance with a treaty obligation.\textsuperscript{111} Thus, if a state’s actions fall within the confines of the NPM clause, the state’s actions do not constitute a violation of the treaty.\textsuperscript{112} The NPM clause is a broadly applicable provision designed to shield the state from liability for carrying out the “particular state objectives” mentioned in the clause.\textsuperscript{113}

Article 25 of the Draft Articles codifies the other necessity defense based on customary international law:

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 way 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.

2. In any case, necessity may not be invoked by a State as a ground for precluding wrongfulness if:
   (a) the international obligation in question excludes the possibility of invoking necessity; or
   (b) the State has contributed to the situation of necessity.\textsuperscript{114}

Unlike an NPM clause, which precludes wrongfulness altogether, Article 25 is concerned with the consequences of wrongfulness. It should not be considered until after a tribunal has determined that a primary rule of international law – such as a BIT obligation – has been violated.\textsuperscript{115} Furthermore, Article 25 is a general rule applicable to all disputes under international law. Thus, a state can claim necessity under Article 25 regardless of whether the treaty includes an express provision to that effect.\textsuperscript{116}

\textsuperscript{110} See Burke-White & von Staden, supra note 108, at 311-12.
\textsuperscript{111} See Draft Articles, General Commentary, supra note 33, at ¶¶ 1-4.
\textsuperscript{112} See CMS Gas Annulment Decision, supra note 34, at ¶ 129 ("Article XI is a threshold requirement: if it applies, the substantive obligations under the treaty do not apply.").
\textsuperscript{113} See Burke-White & von Staden, supra note 108, at 321.
\textsuperscript{114} See Draft Articles, supra note 36, at art. 25.
\textsuperscript{115} See id., General Commentary, at ¶ 3.
\textsuperscript{116} See id., Ch. 5, Commentary, at ¶ 1 ("The existence in a given case of a circumstance precluding wrongfulness in accordance with this chapter provides a shield
Despite clear differences in function and structure, the two provisions have something in common. Both provisions preclude the state from liability under extreme circumstances.\textsuperscript{117} Perhaps for this reason, tribunals are frequently confused as to the relationship between the NPM clause and Article 25. Several awards concluded that the NPM clause and Article 25 are identical.\textsuperscript{118} Separately, the \textit{LG&E} Decision on Liability recognized a clear distinction between the NPM clause and customary necessity. Yet, upon finding Argentina met the standard of customary necessity, the Tribunal made a curious statement: “[w]hile this analysis concerning Article 25 of the Draft Articles on State Responsibility alone does not establish Argentina’s defense, it supports the Tribunal’s analysis with regard to the meaning of Article XI. . .”\textsuperscript{119}

This confusion is in stark contrast to the wording of the Draft Articles, which state that “[c]ircumstances precluding wrongfulness are to be distinguished from other arguments which may have the effect of allowing a State to avoid responsibility.”\textsuperscript{120} Perhaps as a result, all three annulment committee decisions have expressly stated that Article XI and customary necessity are completely distinct.\textsuperscript{121}

\subsection*{3.4.2 – Implications of Multiple Unique Standards}

Determining the limits of the necessity defense under Article 25 of the Draft Articles is critical to understanding the application of investment treaty guarantees at times of crisis. While the NPM clause is a standard provision in some state’s model BITs, it is hardly ubiquitous. A number of important capital exporting states – European states in particular – do not include NPM clauses in their BITs.\textsuperscript{122} This presents a significant problem for many developing states. Capital-exporting states, and some large capital-importing states like India

\textsuperscript{117} The situation with regard to the Draft Articles is somewhat complicated by Article 27, which indicates that wrongful conduct may be excused yet compensation is still due. See Draft Articles, supra note 36, at Art. 27(b).

\textsuperscript{118} See \textit{CMS} Gas Award, supra note 37, at ¶¶ 353-393; \textit{Sempra} Energy Award, supra note 37, at ¶ 375; \textit{Enron} Award, supra note 25, at ¶ 333.

\textsuperscript{119} See \textit{LG&E} Decision on Liability, supra note 12, at ¶ 258-261.

\textsuperscript{120} Draft Articles, supra note 36, Commentary, Chapter 5, at ¶ 7; see also id. at Art. 55 (\textit{lex specialis}).

\textsuperscript{121} See \textit{Enron} Annulment Decision, supra note 2, at ¶¶ 128-136; \textit{CMS} Gas Annulment Decision, supra note 37, at ¶¶ 129-134; \textit{Sempra} Energy Annulment Decision, supra note 37, at ¶¶ 109-118.

\textsuperscript{122} See, e.g., bilateral investment treaties signed by the Netherlands, United Kingdom, France, and Italy, available at http://www.unctadxi.org/templates/Page_1007.aspx.
and China, negotiate BITs based on a model draft written internally. By operating off their own model BIT, these states gain the advantage of a uniform set of obligations resting within their own control. By contrast, smaller developing states generally sign the modified versions of another state’s model BIT.\textsuperscript{123}

With specific regard to the necessity defense, the consequence of signing up for different treaty obligations remains unclear. Developing states are exposed to obligations that are significantly different (NPM versus customary necessity) when dealing with investors of different nationalities. Argentina, for example, may be excused from liability to an investor from the United States but remain liable to a British investor.\textsuperscript{124} In fact, this appears to have occurred already. Of the claims decided under the US-Argentina BIT, the NPM clause is the principal reason that Argentina escaped the lion’s share of liability.\textsuperscript{125} All other decided claims – which involved similar factual allegations but fell under British, French, and Spanish BITs – reached the opposite conclusion because they relied upon Article 25.\textsuperscript{126} Furthermore, due to the MFN clause, claimants may argue that developing states cannot claim any protection under an NPM clause because they have already guaranteed greater protection for similar investments to nationals from other countries.\textsuperscript{127}

3.4.3 – Economic Necessity Under Art. 25

Where a state’s economic necessity defense depends solely upon Article 25, its chances of success are poor. In any arbitration where Argentina has relied upon the Draft Articles’ definition of necessity, it has lost.\textsuperscript{128} The most significant barrier seems to be the man-


\textsuperscript{125} See Chart 1: Group 1, infra Appendix.

\textsuperscript{126} See Chart 1: Group 2, infra Appendix.

\textsuperscript{127} A BIT that lacks an NPM clause provides greater protection for investors, which may have MFN implications. This argument is theoretical, but not without support. See, e.g., CMS Gas Award, supra note 37, at ¶ 343; Pope & Talbot Inc. v. Canada, Award on the Merits of Phase 2, at ¶ 117 April 10, 2001 (UNCITRAL Arbitration), available at http://ita.law.uvic.ca/documents/Award_Merits2001_04_10_Pope_001.pdf.

\textsuperscript{128} See Chart 1, Group 2, infra Appendix.
ner in which the articles are written. The Draft Articles are a codification of the “basic rules of international law concerning the responsibility of States . . .”¹²⁹ They apply to the “whole field of international obligations of states.”¹³⁰ Thus, they are “general in nature” and expressed “at a high level of abstraction.”¹³¹ Furthermore, the articles are largely the result of historical precedent rather than purposeful thought.

With regard to Article 25, prior cases have primarily considered the obligations of states to other states.¹³² Investment treaty arbitration is never considered, nor are the complexities related to monetary policy. The consequence for Argentina is that it must force a square peg into a round hole. Several international tribunals have recognized the existence of the necessity defense in principle,¹³³ although no state has ever succeeded on the merits.¹³⁴ Necessity will only exist in “those exceptional cases where the only way a State can safeguard an essential interest threatened by a grave and imminent peril is, for the time being, not to perform some other international obligation of lesser weight or urgency.”¹³⁵

There are four elements required for a successful claim of necessity: (1) the minimum threshold, (2) the comparative threshold, (3) non-preclusion, and (4) non-contribution. Failure to satisfy any one requirement results in a failure to assert the claim. First, per the minimum threshold requirement, the state’s wrongful action must have been “the only way for the State to safeguard an essential interest against a grave and imminent peril.”¹³⁶ This requires the state to prove the existence of an “essential interest,” a “grave and imminent peril,” and the lack of more lawful alternatives. Second, per the com-

---

¹²⁹ Draft Articles, General Commentary, supra note 36, at ¶ 1.
¹³⁰ Id. at ¶ 5.
¹³² See Draft Articles, General Commentary, supra note 36, at ¶ 3-14.
¹³³ See, Gabêikovo-Nagyamaros Project (Hungary v. Slovakia), Judgment, 1997 I.C.J. 7, ¶¶ 51-52 (rejecting the claim of necessity because Hungary contributed to the crisis) [hereinafter Gabêikovo-Nagyamaros Project]; Affaire de l’indemnité russe (Russian Indemnity) (Russia, Turkey), 11 R.I.A.A. 421, 443 (1912) (rejecting the claim of necessity – or force majeure – because the Ottoman Empire could have paid without threatening its state).
¹³⁴ See Draft Articles, General Commentary, supra note 36, at ¶ 3; see also LG&E Decision on Liability, supra note 21 (“[t]he Tribunal noted that the state of necessity defense under international law (Article 25 of the International Law Commission’s Draft Articles on State Responsibility) also supported the Tribunal’s conclusion.”).
¹³⁵ Draft Articles, General Commentary, supra note 36, at ¶ 1 (emphasis added).
¹³⁶ Id. at Art. 25(1)(a).
parative threshold requirement, the states’ wrongful action cannot have “seriously impaired an essential interest” of another state or the international community. “[T]he interest relied on must outweigh all other considerations . . .”\textsuperscript{137} Third, per the non-preclusion requirement, the international obligation cannot preclude necessity as a defense. Fourth, per the non-contribution requirement, the state cannot claim necessity if it has “contributed to the situation of necessity.” According to the International Court of Justice (“ICJ”) contribution may be “by act or omission.”\textsuperscript{138} The result is that a state must cumulatively establish six difficult elements to successfully claim necessity.

\begin{center}
\begin{tikzpicture}
\node{Necessity} child{node{Minimum Threshold} edge from parent[->] child{node{Comparative Threshold} edge from parent[->] child{node{Essential Interest} edge from parent[->]}} child{node{Grave and Imminent Peril} edge from parent[->] edge from parent[->] child{node{Lack of More Lawful Alternatives} edge from parent[->]}} edge from parent[->] edge from parent[->] child{node{Non-Preclusion} edge from parent[->]}};
\end{tikzpicture}
\end{center}

Cumulatively Satisfied

With regard to the claims against Argentina, three distinct positions have formed along the spectrum of necessity. For ease of analysis, they are referred to here as the Restrictive position, the Moderate position, and the Liberal position.\textsuperscript{139}

\begin{flushright}
\textsuperscript{137} Id. at Art. 25(1)(b); Draft Articles, General Commentary, supra note 36, at \textsection 17.
\textsuperscript{138} Gabèikovo-Nagymaros Project, supra note 133, at \textsection 57.
\textsuperscript{139} Several opinions – the Continental Casualty Award, the CMS Gas Annulment Decision and the Sempra Energy Annulment Decision – do not fall into any of these positions due to the fact that they do not address the question of necessity.
\end{flushright}
The Restrictive position, adopted by the CMS Gas, Sempra Energy, Enron, and BG Group awards, would apply the necessity test in a manner so strict as to be effectively impossible. According to these tribunals, Argentina could not meet a single element of the necessity test under Article 25 because (1) there can be no “essential interest” where the existence of the state is not threatened; (2) there are “always many approaches” that a state may employ to combat economic crises; (3) Argentina clearly contributed to the state of necessity; (4) Argentina’s actions impacted the essential interests of private investors, which the tribunals equated to an interest of the state. Another award, BG Group, doubted whether the Draft Articles could even be invoked in a dispute against a private investor.

These decisions are erroneous as to both fact and law. The historical record indicates that the existence of the Argentine state was under threat. Moreover, an “essential interest” need not be so severe as to threaten the existence of the state. The Draft Articles cite multiple incidents in which states have claimed necessity to protect either an important industry or the local environment. The ICJ similarly held environmental protection as an essential interest of the state. Why a state’s economic stability is unclear. As to the statement in the BG Group Award that necessity may be inapplicable altogether, the tribunal cites no authority and no other tribunal takes such a strict position. For these and other reasons, the Restrictive position has been significantly criticized and even annulled by three separate IC-SID annulment committees.

The InterAgua and Vivendi/AWG Group decisions adopted the Moderate position. These opinions recognized that domestic stability (in these cases the continuous operation of water utilities) amidst an

under Article 25 without simultaneously referencing the NPM clause. Several tribunals have confused these two standards. See Part 3.4.1, supra. Also, the National Grid Award cannot be categorized because it relies solely upon the non-contribution element to reject the necessity defense. National Grid Award, supra note 32, at ¶ 257-262.

CMS Gas Award, supra note 37, at ¶ 315-331 Sempra Energy Award, supra note 37, at ¶ 344-355; Enron Award, supra note 37, at ¶ 303-313 BG Group Award, supra note 37, at ¶ 407-412.

Enron Award, supra note 37, at ¶ 305.

Id. at ¶ 308 (emphasis added).

Id. at ¶¶ 311-312.

Id. at ¶¶ 341-342.

BG Group Award, supra note 37, at ¶¶ 408-409.

See generally Draft Articles, General Commentary, supra note 36, at ¶¶ 5-14.

See Gapeitkovo-Nagymaros Project, supra note 133, at ¶ 53.

See generally CMS Award, supra note 37; Sempra Energy Award, supra note 37; Enron Award, supra note 37.
economic crisis constituted an “essential interest.”\textsuperscript{149} The state’s actions, which profoundly affected investors, did not affect an essential interest of other states.\textsuperscript{150} Furthermore, BITs do not preclude the necessity defense. Despite this, the Moderate position rejects two aspects of Argentina’s defense. First, regarding the minimum threshold, the tribunals suggest that Argentina’s measures were not the “only way” for it to deal with the crisis.\textsuperscript{151} That said, Argentina’s refusal to negotiate in good faith with the water utilities may have been particularly extreme in these cases.\textsuperscript{152} Second, with regard to the non-contribution requirement, the tribunals recognized that a combination of endogenous and exogenous factors created the crisis. Consequently, certain endogenous factors – “excessive public spending, inefficient tax collection, delays in responding to the early signs of the crisis, insufficient efforts at developing an export market, and internal political dis- sension and problems inhibiting effective policy making” – were attributed to Argentina.\textsuperscript{153} The IMF’s post-mortem report corroborates these conclusions.\textsuperscript{154} Thus, the Moderate position also rejects Argentina’s necessity defense, albeit on narrower grounds than the Restrictive position.

The LG&E Decision on Liability and the Enron Annulment Decision adopted the Liberal position. According to the LG&E decision, economic stability was an “essential interest.”\textsuperscript{155} An “across the board response” was the “only way” to counteract the crisis. Additionally, there was “no serious evidence” that Argentina contributed to the crisis.\textsuperscript{156} However, even the LG&E decision does not fully embrace Article 25. According to the tribunal, its decision depended upon the presence of an NPM clause in the US-Argentina BIT.\textsuperscript{157}

The other case adopting the Liberal position – the Enron Annulment Decision – represents a broadside attack on the Restrictive interpretation of customary necessity. With regard to the minimum threshold, the committee noted that the phrase “only way” is “capable of more than one possible interpretation.” A literal interpretation would preclude the possibility of finding economic necessity because

\textsuperscript{149} See InerAgua Decision on Liability, supra note 1, at ¶ 238.
\textsuperscript{150} See id. at ¶ 239.
\textsuperscript{151} See id. at ¶ 238.
\textsuperscript{152} See Id. at ¶ 215. See also AWG Group/Vivendi, supra note 1, at ¶ 260 (“Argentina could have attempted to apply more flexible means to assure the continuation of the water and sewage services . . . and at the same time respected its obligations . . . ”).
\textsuperscript{153} Id. at ¶¶ 241-242.
\textsuperscript{154} See IMF INDEPENDENT EVALUATION REPORT, supra note 22, at 64.
\textsuperscript{155} LG&E Decision on Liability, supra note 12, at ¶ 251.
\textsuperscript{156} Id. at ¶¶ 246-257.
\textsuperscript{157} LG&E Decision on Liability, supra note 12, at ¶ 258.
there are always multiple possibilities (indeed, this is the principal error of the Restrictive Position). Alternatively, if a tribunal defined "only way" as the least offensive way\textsuperscript{158} while recognizing that a measure must have a high likelihood of success before it can constitute an "option" at all,\textsuperscript{159} then the possibility of finding that a measure constituted the "only way" became very real.

The committee also asked whether the determination should be made with "the benefit of . . . hindsight" or if the state should be given a "margin of appreciation."\textsuperscript{160} With regard to the non-contribution requirement, the committee wondered whether contribution must be deliberate, reckless, or simply negligent.\textsuperscript{161} Finally, the committee criticized the tribunal for relying solely upon the report of an economic expert to answer both the minimum threshold requirement and the non-contribution requirement.

While an economist might regard a State’s economic policies as misguided, and might conclude that such policies led to or amplified the effects of an economic crisis, that would not of itself necessarily mean that as a matter of law, the State had ‘contributed to the situation of necessity’ so as to preclude reliance on the principle of necessity under customary international law.\textsuperscript{162}

The Enron Annulment Decision, which represents the most recent critique of necessity analysis to date, brings to the forefront many of the problems involved in applying the Draft Articles to investment treaty disputes. The opinion clearly illustrates how the Draft Articles – which are defined in rather abstract terms – do not directly address the complex issues arising under the unique fact patterns of investment disputes.\textsuperscript{163} Annulment decisions are not like an appeal, so the Enron committee did not reach conclusions of law; it merely posed questions. The underlying message of the decision, however, is that the Draft Articles are malleable. They bend to fit the needs of individual disputes.

Taken as a whole, these opinions are widely divergent. Some cases would freely grant Argentina’s defense while others question whether the defense even exists. Divergent interpretations of identical facts are problematic because any conflict urges states to follow the most restrictive interpretation in order to avoid future liability. Consequently, states wishing to avoid liability must assume that the ne-

\textsuperscript{158} Enron Annulment Decision, supra note 2, at ¶ 369-370.
\textsuperscript{159} Id. at ¶ 371.
\textsuperscript{160} Id. at ¶ 372.
\textsuperscript{161} Id. at ¶ 389.
\textsuperscript{162} Id. at ¶ 393.
\textsuperscript{163} See Bodansky & Crook, supra note 131, at 790.
cessity defense is completely non-operative. This is particularly so because the trend of jurisprudence runs against Argentina.

PART IV: IMPLICATIONS AND RECOMMENDATIONS

4.1 – Implications of the Dominant Jurisprudence

The application of BIT liability to financial crises entails several negative consequences. First, it creates a profound tension between the powerful need for reform and the prospect of significant liability. The more severe the crisis, the more likely that reform is necessary. Yet, the more profound the reform, the more likely that investors will initiate investment treaty claims. Second, it incentivizes investors to make poor investing choices and thereby creates moral hazard in the market place. Third, it hobbles the ability of states to recover.

4.1.1 – Tension Between Necessary Reform and Potential Liability

As described in Part II, supra, economic crises are a normal part of the economic cycle. They are difficult to predict, profoundly destabilizing, almost always require government intervention, and have long-term consequences. Furthermore, crisis frequently leads to sovereign default. Due to a lack of robust institutions and a perceived weakness by international markets, developing states are more susceptible to both economic crisis and default. All states remain subject to the same cycle, even if the period between crises may be longer for some states.164

Under the strict interpretation of investment treaty protections, these practical considerations fall by the wayside. The modern interpretation of BIT standards emphasizes the investor’s “legitimate” expectations over the needs of the state to regulate. The fair and equitable treatment standard in particular forces the state to maintain a stable legal environment. The necessity defense under customary international law is no avenue for defense. Even where the state determines in good faith that the best remedy for its citizens and the economy over the long-term may be to enact reform, liability is due.165 Even where the state cannot pay, liability is due. Even in situations where a dramatic alteration in policy is forced upon the state, liability will be due because there are always endogenous factors that cause

164 See supra Part II.
165 See CMS Gas Award, supra note 37, at ¶ 280 (“The tribunal believes this is an objective requirement unrelated to whether the Respondent has had any deliberate intention or bad faith. . . ”).
economic crises. Viewed with the advantage of hindsight, the flaws in
economic policy are always clear to economists and tribunals.
Consequently, the only way for a state to avoid liability is by imple-
menting perfect economic policy at the outset. Tribunals do not admit
this expressly, but such is the effect of jurisprudence. According to
current jurisprudence, the investor can develop a “reasonable” expect-
ation based upon an unsustainable policy because reasonableness
does not depend upon whether government guarantees are even prac-
tical.166 The state’s reasons for enacting legal reform are similarly ir-
relevant.167 Even where the need for reform is extreme, failure to
enact initially perfect policy leads tribunals to conclude that the state
has “contributed” to the crisis.168 After all, these tribunals imply, the
need for reform is serious only because the proper policy was not im-
plemented in the first place. On that basis, tribunals consistently re-
ject the necessity defense.169

Accordingly, this jurisprudence creates tension between the
state’s regulatory obligations and its liability under investment trea-
ties. Reform may be necessary, but investment treaty protections act
as disincentives. Argentina’s predicament reveals this tension may be
extreme. Many economists concluded that Argentina had to break the
Convertibility regime and devalue its currency, pesification all debts
in dollars, and default on its massive foreign debts. In fact, the IMF
determined that Argentina waited too long to break Convertibility.170
Nevertheless, angered foreign investors now insist they are due bil-
lions of dollars in lost assets and profit, a great deal more than Argent-
tina can pay. Bondholders who happily purchased high yield
Argentine bonds (directly related to greater country risk) now insist
they have a guaranteed right to the repayment of billions of dollars in
defaulted debt.171 Whatever the merits of an economic policy frozen in
time may be during a period of relative stability, an economic crisis
brings the shortcomings of this philosophy into sharp relief. This is
how, as Professor Pedro Nikken wrote, BIT jurisprudence obligates
countries “beyond what the canons of good governance would
require.”172

166 See supra Part 3.1.2.
167 See Semptra Energy Award, supra note 37, at ¶ 304.
168 See, e.g., National Grid Award, supra note 43, at ¶ 258.
169 See e.g., id. at ¶ 260.
170 IMF INDEPENDENT EVALUATION REPORT, supra note 22, at 64 (noting that Con-
vertibility, while successful in ending hyperinflation, had significant drawbacks in
the medium term).
171 See generally Becarra Order, supra note 45.
172 Vivendi/AWG Group Decision on Liability (Separate Opinion of Prof. Pedro
Nikken), supra note 1, at ¶ 20, available at http://ita.law.uvic.ca/documents/Suez
VivendiAWGSeparateOpinion.pdf (emphasis added).
4.1.2 – Moral Hazard

Moral hazard – defined by Krugman as “[t]he possibility that you will take less care to prevent an accident if you are insured against it”173 – may be embedded within the current system of BIT protections. Although determining the precise effects of moral hazard is difficult, the concern is serious enough to warrant further study.174 By granting investors an enforceable legal right without obligating them to complete their due diligence, the BIT system encourages investors to make bad investments in foreign markets. Obviously, BITs were not designed to accomplish this purpose. Nonetheless, it may have happened to Argentina. By emphasizing the fact that Argentina promoted its investor-friendly climate, tribunals hold Argentina liable to the letter of every guarantee. Investors, by contrast, are entirely excused for participating in an asset bubble driven by irrational euphoria.

4.1.3 – Long-Term Consequences

Reinhart and Rogoff demonstrate that financial crises have long-term impacts on the economy. Regardless of the cause or nature of the crisis, the state requires several years before returning to pre-crisis levels of economic stability and output.175 However, if a state is subjected to a wave of arbitration claims – as Argentina has been – it may prolong the state’s period of insolvency. As of January 2010, holdout bondholders have successfully frozen over US$2 billion of Argentina’s assets in the United States through domestic litigation.176 Extending this power to international tribunals under the Washington and New York Conventions would allow for the full-scale internationalization of bondholder claims. Bondholders would hold guaranteed rights that are internationally enforceable, which discourages them from reaching a negotiated solution.177 Even with modern sovereign bonds that include CACs, 75% of bondholders must agree before the

173 See Krugman & Obstfeld, supra note 43, at 591; see also Desai, supra note 13, at 242 (“Moral hazard is invoked in situations involving human responses that tend to be reckless if their consequences are guaranteed not to be penalized.”).
174 See Jeffrey A. Frankel & Nouriel Roubini, The Role of Industrial Country Policies in Emerging Market Crises, Economic and Financial Crises in Emerging Market Economies, 198-200 (Martin Feldstein ed. 2003) (“Both debtor moral hazard and creditor moral hazard deriving from expectations of bailout via official support are important enough to be a concern for the design of an efficient international financial system.”).
175 See Reinhart & Rogoff, supra note 13, at 236.
177 See ICSID Convention, supra note 9, at Art. 53-54 (providing that awards are binding, without rights of appeal, and enforceable in all member states).
settlement becomes mandatory. If one in four bondholders prefers investment arbitration to a negotiated settlement, then the negotiation will fail. The result is that power shifts significantly from the state to bondholders in settlement negotiations.

These drawbacks – discouraging necessary reform, encouraging poor investment choices, and prolonging the period of default – speak to the fact that investment arbitration simply was not designed to resolve sovereign bankruptcy. Applying these standards without regard to the implications does real damage to the citizens who must bear the burden of a drawn out process of BIT arbitration involving massive claims.

4.2 – Recommendations

Depending upon how one interprets the problem, there are a number of different potential resolutions to the sovereign debtor’s trap. Some commentators see these claims as part of a larger structural problem with the entire system. They argue for the establishment of a permanent appellate body that can address a range of issues affecting the legitimacy of the BIT system. The criticism is valid enough to convince the United States to amend its own model BIT in anticipation of such a system. With regard to the economic necessity defense, a permanent appellate body of experts appointed by states may have a greater sensitivity to the complex issues involved in an economic crisis. Furthermore, due to the myriad of contradictory opinions, there is probably no way to reconcile them without a structural reform of the entire system. That said, an appellate court is not a panacea. Several of the arbitrators who found Argentina’s behavior completely inexcusable are themselves experts in international law with significant experience in government.

Other commentators focus on general problems with BIT interpretation – specifically the tribunal’s failure to sufficiently consider the state’s regulatory responsibilities. These commentators recom-

---

179 Waibel, supra note 105, at 758 (“Because of the higher expected recovery (in dollars, taking into account the likelihood of repayment), bondholders will be more inclined to hold out and, bundling their claims whenever possible, to seek payment through arbitration.”).
mend that tribunals consider the emerging concept of international regulatory law, which would weigh both the investor’s expectations in conjunction with other values that are particularly important to a well functioning state.\textsuperscript{182} This proposal also has merit. Many of the tribunals who have found Argentina liable display an almost dogmatic adherence to the notion of \textit{pacta sunt servanda}. They fail to appreciate that unforeseeable consequences often arise, which governments must address regardless of previously held positions.

These proposals are worthwhile. Indeed, policymakers probably should have considered them \textit{before} the world ratified 2,000-plus bilateral treaties, a web of competing obligations from which it may be impossible to extricate. However, creating an international appellate body remains unlikely in the near term. Furthermore, recommending that arbitrators fundamentally alter their interpretive approach may not be well received by the loose association of arbitrators who have labored to build a body of precedent upon which they now rely. Instead, the best reform may be less revolutionary.

The principal issue with regard to the claims against Argentina is that they do not comport with economic realities, and since macroeconomic fundamentals are not about to change, the current legal reasoning should be altered. Otherwise, BITs will not serve the purpose of their existence, which is to encourage economic growth.\textsuperscript{183}

Rather than following the current strict interpretations of necessity, one can reasonably argue that many prior tribunals have reached an absurd conclusion based upon an excessively literal interpretation of international law. Assuming \textit{arguendo} that (a) investment treaties protect investor expectations without limitation and (b) a claim of economic necessity is impossible to establish because states always contribute to their own economic demise, the fact remains that the state is insolvent. Although BITs may be designed to apply when property guarantees are \textit{unpopular}, they are \textit{not} designed to act as a form of insolvency law for sovereign states. If the drafters of these agreements had intended as much, then model BITs would include express provisions regarding the consolidation of claims, attachable versus protected property, restructuring of debt, \textit{et cetera}. Furthermore, given the nature of the global economy, any insolvency agreement would have to be multilateral in order to function. Thus, by applying the terms of the treaty literally, tribunals have failed to adhere to the


\textsuperscript{183} See US-Argentina BIT, supra note 26, at Preamble (encouraging the “maximum effective use of economic resources” and “desiring to “increase prosperity in both states.”).
treaty's implied limitations. This constitutes a manifest excess of power and none of these decisions should be followed.

The more difficult question, though, is determining what the appropriate response should be. It is one thing to say that prior tribunals are wrong, quite another to definitively state what is right. Furthermore, given the fact that no one seriously considered this issue during the process of treaty negotiation, it must be conceded that there is no "right answer." The best solution must integrate two competing values. On the one hand, BITs are applicable even in difficult circumstances. On the other hand, BITs do not apply to financial crises where the notion of individual ad hoc claims does not comport with the reality of multiple claimants battling over the assets of an insolvent state whose assets are best preserved for its suffering population.

It is submitted that the best resolution to this problem is to follow ICJ's analysis in the Gabèikovo-Nagymaros Project.\textsuperscript{184} This case involved a treaty between Hungary and Slovakia for the long-term joint development of a hydroelectric facility along the Danube River. After several years, it became increasingly clear that the project was environmentally unsustainable under the treaty's original plan. Due to these concerns, Hungary suspended the treaty.\textsuperscript{185} Accordingly, the ICJ faced a similar problem of competing values. A valid treaty existed and both parties had already expended enormous effort and money; but the potential detriments of enforcing the literal terms of the treaty were real.

The ICJ determined that the "good faith" element of Article 31 of the Vienna Convention on the Law of Treaties ("VCLT") required consideration of new circumstances.\textsuperscript{186} Consequently, while the ICJ rejected Hungary's assertion of necessity on the basis that it had contributed to the problem,\textsuperscript{187} it nevertheless recognized that changed circumstances must always be considered.

Such new norms have to be taken into consideration, and such new standards given proper weight, not only when States contemplate new activities but also when continuing with activities begun in the past. This need to reconcile economic development with protection of the environment is aptly expressed in the concept of sustainable development.\textsuperscript{188}

\begin{flushleft}
\textsuperscript{184} See Gabèikovo-Nagymaros Project, supra note 133.
\textsuperscript{185} Id. at ¶ 32-33.
\textsuperscript{187} Gabèikovo-Nagymaros Project, supra note 133, at ¶ 50-58.
\textsuperscript{188} Id. at ¶ 140.
\end{flushleft}
Replace the word “environment” with “economy” and the Gabei kovo-Nagymaros Project is directly on point.\textsuperscript{189} The ICJ’s ruling directs that “it is the purpose of the Treaty, and the intentions of the parties in concluding it, which should prevail over its literal application.”\textsuperscript{190} Thus, the ICJ ordered the parties to renegotiate in good faith.\textsuperscript{191}

Several of the Argentine tribunals cited Gabei kovo-Nagymaros Project approvingly in order to demonstrate that their strict interpretation of the necessity defense was accurate.\textsuperscript{192} However, they failed to address what the case actually stands for – the notion that “good faith” under the VCLT requires the parties to address new problems through renegotiation. Incidentally, the Unidroit Principles on International Commercial Contracts (“PICC”) provide the same remedy for hardship, Art. 6.2.1-6.2.3.\textsuperscript{193} Where an event “fundamentally alters the equilibrium of the contract”, a disadvantaged party is entitled to request renegotiation in good faith and even seek the assistance of a court in the process.\textsuperscript{194} Furthermore, as mentioned above, renegotiation under CACs is the current chosen remedy for sovereign bond defaults.\textsuperscript{195}

Indeed, exceptions to liability exist throughout international law. The ICJ has noted, for example, that “[e]very system of law must provide . . . for interferences with the normal exercise of rights during public emergencies and the like.”\textsuperscript{196} Article XX of the General Agreement on Tariffs and Trade permits states to enact any law that it deems necessary to accomplish a variety of policy goals.\textsuperscript{197} Article 79 of the United Nations Convention on Contracts for the International Sale of Goods exempts an otherwise liable party where failure of per-

\textsuperscript{189} See Alexander Orakhelashvili, The Interpretation of Acts and Rules in Public International Law 182 (2008) (“[S]ustainable development is referred to in a number of international instruments, mostly in the field of international environmental law and international economic law.”).

\textsuperscript{190} Gabei kovo-Nagymaros Project, supra note 133, at ¶ 142.

\textsuperscript{191} Id. at ¶ 140 (“For the purposes of the present case, this means that the Parties together should look afresh at the effects on the environment of the Gabei kovo power plant.”).

\textsuperscript{192} See, e.g., Enron Award, supra note 25, at ¶ 313.


\textsuperscript{194} Id.

\textsuperscript{195} See Haldane, supra note 179.


\textsuperscript{197} General Agreement on Tariffs and Trade, Art. XX, Oct. 30, 1947, 55 U.N.T.S. 194.
formance is due to an impediment beyond the party’s control. These rules of exception—found in public international law, international contract law, and international economic law—address the fundamental unpredictability of economic circumstances.

Admittedly, the notion of forced renegotiation is not without flaws. Most significantly, BITs do not provide for a renegotiation process. A tribunal, thus, runs the risk of annulment for issuing an order to renegotiate. But then again, the current strain of jurisprudence has already been significantly criticized and annulled twice. Furthermore, BITs do not limit an arbitral tribunal’s ability to consider outside sources of international law. Most BITs call for tribunals to decide according to the “applicable principals of international law.” These provisions permit tribunals to consider the necessity defense under Article 25 of the Draft Articles. They also permit tribunals to consider other aspects of international law, such as the obligation to interpret treaties in “good faith” and the resolution adopted in the Gabëiko-Nagymaros Project.

CONCLUSION

Jurisprudence with regard to the necessity defense is unsatisfactory for a number of reasons. Most importantly, the dominant position effectively precludes a state from successfully claiming economic necessity ab initio. This is concerning because all countries are likely to experience an economic crisis over time. By ratifying BITs with significantly different provisions, they are obligated to comply with divergent treaty obligations. Furthermore, developing countries are at greater risk of economic crisis and default. Thus, their exposure to massive liability is very real.

Accordingly, arbitral tribunals need to consider the greater implications of their awards in order to reach a just solution. It is submitted that tribunals should force the parties to renegotiate rather than apply full liability upon the state. Compulsory renegotiation has the advantage of preserving the state’s treaty obligations without overestimating the investor’s “legitimate” expectations amidst a crisis. There are likely to be other possible solutions. Given the lack of a

200 See, e.g., UK-Argentina BIT, supra note 124, at Art. 8(4).
201 See LG&E Decision on Liability, supra note 21, at ¶ 85.
clear answer under the law, no order of priority can be established. It is clear, however, that failure to consider these greater implications would constitute error by undermining the intentions of the states that ratify investment treaties.
## APPENDIX

### Chart 1: Published Opinions re Argentine Crisis Arbitrations
(Organized according to relevant treaty and similarity of claim)

**Group 1:** Treaty = US-Argentina BIT  
Industry = Regulated Utility (Gas Distribution/Transportation)  
Major Claim = Violation of the expressly guaranteed tariff regime denominated in $US and adjusted per US price indexes

<table>
<thead>
<tr>
<th>Case &amp; Venue</th>
<th>Phase</th>
<th>Date</th>
<th>Fair &amp; Equitable Treatment Violation</th>
<th>Umbrella Clause Violation</th>
<th>Customary Necessity Defense</th>
<th>NPM Clause Defense</th>
<th>Award</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>CMS Gas</td>
<td>ICSID Tribunal</td>
<td>05/12/05</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Award of US$133.2M plus interest. Partially annulled without impact on liability; but highly critical of the tribunal's decision.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Annulment Cmte.</td>
<td>09/25/07</td>
<td>Accepted without official endorsement of the legal reasoning</td>
<td>No; Annulled</td>
<td>N/A</td>
<td>Error of law, but insufficient to annul</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Enron</td>
<td>ICSID Tribunal</td>
<td>05/22/07</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Award of US$106M plus interest</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Annulment Cmte.</td>
<td>07/30/10</td>
<td>Accepted without official endorsement of the legal reasoning</td>
<td>Accepted without official endorsement of the legal reasoning</td>
<td>Error of law; Annulled</td>
<td>Error of law; Annulled</td>
<td>Fully Annulled.</td>
<td></td>
</tr>
<tr>
<td>LG&amp;E</td>
<td>ICSID Tribunal</td>
<td>10/03/06</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Argentina remains liable for periods of non-emergency; US$57M plus interest.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Annulment Cmte.</td>
<td>N/A</td>
<td></td>
<td>Suspended by parties' continuing agreement</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sempra Energy</td>
<td>ICSID Tribunal</td>
<td>09/20/07</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Award of US$128M plus interest</td>
<td>Fully Annulled.</td>
</tr>
<tr>
<td></td>
<td>Annulment Cmte.</td>
<td>06/29/10</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>Yes; Annulled</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Chart 1 Continued: Published Opinions re Argentine Crisis Arbitrations
(Organized according to relevant treaty and similarity of claim)

| Group 2: Treaties = UK-Argentina, France-Argentina, and Spain-Argentina BITs |
| Industry = Regulated Utility (Gas Distribution/Transportation, Electrical Power, or Municipal Water Supply) |
| Major Claim = Violation of the expressly guaranteed tariff regime, in some cases expressly denominated in US |

<table>
<thead>
<tr>
<th>Case &amp; Venue</th>
<th>Phase</th>
<th>Date</th>
<th>Award</th>
</tr>
</thead>
<tbody>
<tr>
<td>BG Group</td>
<td>UNCTRL Tribunal</td>
<td>12/24/07</td>
<td>Yes</td>
</tr>
<tr>
<td>U.S Judicial</td>
<td>06/07/10</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| National Grid | UNCTRL Tribunal | 11/03/08 | Yes | Fair & Equitable Treatment Violation | N/A | Umbrella Clause Violation | No (rejected on procedural grounds) | No | Customary Necessity Defense | N/A |
| U.S Judicial Appeal | 06/07/10 | | | | | | | | Award of US$54M plus interest. |

| Sociedad General de Aguas de Madrid / AWG Group | ICSID / Annulment Cmts. | 06/07/10 | Yes | Fair & Equitable Treatment Violation | N/A | Umbrella Clause Violation | No | Customary Necessity Defense | N/A |

| Calculation of liability deferred for Pending |

| Vivendi / ICSID / ICSID / | Appeal / Annulment | 06/07/10 | Yes | Fair & Equitable Treatment Violation | N/A | Umbrella Clause Violation | No | Customary Necessity Defense | N/A |

| Calculation of liability deferred for Pending |

| Group 3: Treaty = US-Argentina BIT |
| Industry = Regulated Insurance (Workers’ Accident Insurance) |
| Major Claim = Violation of Convertibility regime; forced “pesification”; freeze on bank withdrawals and transfers. |

<table>
<thead>
<tr>
<th>Case &amp; Venue</th>
<th>Phase</th>
<th>Date</th>
<th>Award</th>
</tr>
</thead>
<tbody>
<tr>
<td>Continental Casualty</td>
<td>ICSID Tribunal</td>
<td>09/05/08</td>
<td>Precluded by Art. XI, and also criticized.</td>
</tr>
<tr>
<td>Continental Casualty</td>
<td>ICSID / Annulment Cmts.</td>
<td>N/A</td>
<td></td>
</tr>
</tbody>
</table>

* N/A: Not Applicable; either because the relevant treaty contains no such provision, the claimant made no such claim, or (during annulment/appeal) the deciding body failed to address the issue.
<table>
<thead>
<tr>
<th>Case</th>
<th>Nationality / Treaty</th>
<th>Arbitral Body</th>
<th>Date</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>CMS Gas Award</td>
<td>US</td>
<td>ICSID</td>
<td>05/12/05</td>
<td>No state of necessity existed; Award of US$133.2M plus interest.</td>
</tr>
<tr>
<td>LG&amp;E Decision on Liability</td>
<td>US</td>
<td>ICSID</td>
<td>10/03/06</td>
<td>State of necessity existed, but liability remains for periods of non-emergency; subsequently awarded US$57M plus interest.</td>
</tr>
<tr>
<td>Enron Award</td>
<td>US</td>
<td>ICSID</td>
<td>05/22/07</td>
<td>No state of necessity existed; Award of US$106M plus interest.</td>
</tr>
<tr>
<td>CMS Annulment</td>
<td>US</td>
<td>ICSID</td>
<td>09/25/07</td>
<td>Significant Criticism, finding multiple errors of law, but not annulled.</td>
</tr>
<tr>
<td>Sempra Energy Award</td>
<td>US</td>
<td>ICSID</td>
<td>09/28/07</td>
<td>No state of necessity existed; award of US$128M plus interest.</td>
</tr>
<tr>
<td>BG Group Award*</td>
<td>UK</td>
<td>UNCITRAL</td>
<td>12/24/07</td>
<td>No state of necessity existed; award of US$185M plus interest.</td>
</tr>
<tr>
<td>Continental Casualty Award</td>
<td>US</td>
<td>ICSID</td>
<td>09/05/08</td>
<td>Art. XI Necessity precludes most liability; US$2.8M plus interest.</td>
</tr>
<tr>
<td>National Grid Award</td>
<td>UK</td>
<td>UNCITRAL</td>
<td>11/03/08</td>
<td>No state of necessity existed; Award of US$54M plus Interest.</td>
</tr>
<tr>
<td>National Grid Appeal</td>
<td>UK</td>
<td>UNCITRAL</td>
<td>06/07/10</td>
<td>Dismissed on procedural grounds – Argentina's delay in filing its petition to vacate.</td>
</tr>
<tr>
<td>BG Group Appeal</td>
<td>UK</td>
<td>UNCITRAL</td>
<td>06/07/10</td>
<td>Dismissed due to the appellate court's lack of discretion to set aside the award.</td>
</tr>
<tr>
<td>Sempra Energy Annulment</td>
<td>US</td>
<td>ICSID</td>
<td>06/29/10</td>
<td>Fully annulled on the basis that the tribunal misinterpreted the NPM clause.</td>
</tr>
<tr>
<td>VivendiAWG Group Decision on Liability</td>
<td>France, Spain, &amp; UK</td>
<td>ICSID &amp; UNCITRAL</td>
<td>07/30/10</td>
<td>Violation of the fair and equitable treatment standard; Necessity defense rejected; Award on Damages pending.</td>
</tr>
<tr>
<td>Sociedad General de Aguas de Barcelona Decision on Liability</td>
<td>France &amp; Spain</td>
<td>ICSID</td>
<td>07/30/10</td>
<td>Violation of the fair and equitable treatment standard; Necessity defense rejected; Award on Damages pending.</td>
</tr>
<tr>
<td>Enron Annulment</td>
<td>US</td>
<td>ICSID</td>
<td>07/30/10</td>
<td>Fully annulled on the basis that the tribunal misinterpreted both the NPM clause and customary international necessity.</td>
</tr>
</tbody>
</table>

* The BG Group tribunal's award was originally confidential. The opinion did not become publicly available until Argentina submitted its petition to vacate the award on Mar-21-2008.