# STATE OF NECESSITY:

## CAN ECONOMIC DISTRESS BE ANALYSED UNDER THE RULES OF CUSTOMARY INTERNATIONAL LAW?

AN INSIGHT TO THE INVESTOR-STATE DISPUTES IN THE ICSID CASES AGAINST ARGENTINA

GRADUATION THESIS


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## ABSTRACT

The present thesis explores the applicability of the state of necessity defence developed by the International Law Commission, recognized as customary international law, to international investment disputes related to the situation of economic and financial distress suffered by host States, using the Argentinean ICSID cases, among others, as a case study.

## RESUMEN

La presente tesis explora la aplicabilidad de la defensa de estado de necesidad desarrollada por la Comisión de Derecho Internacional, reconocida como costumbre internacional, a disputas internacionales de inversión relacionadas con la situación de emergencia económica y financiera sufrida por los Estados receptores de la inversión, utilizando los casos argentinos ante el CIADI, entre otros, como los casos de estudio.

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# INTRODUCTION

Within the scheme of International Public Law, it is possible to encounter a special regime dedicated to issues of Investment Law. At first sight, the topic of investment might appear as an exclusively private area, due to the fact that it usually entails the commitment of an individual's private capital in specific projects. However, in the international scenario, the investment topic is part of the public realm inasmuch as States are the subjects that acquire international legal obligations through Bilateral Investment Treaties (BITs) and investment chapters in Free Trade Agreements (FTAs).

In the international instruments mentioned above, States commit with each other to the reciprocal protection of investments made by investors who are nationals of the contracting parties in the treaty. International Investment Agreements usually contain 3 main sections. One of them deals with the scope of application of the treaty, that is, the definition of investment under the treaty, which indicates the types of assets to be protected and the characteristics these investments must possess. It also contains the definition of investor and the territory in which the protection shall apply, establishing who can pursue legal protection under the agreement (rules on nationality) and which geographical locations are considered to be the territory of the other party.

Another segment sets forth the obligations, also known as the standards of protection, which each State must grant to the nationals of the other contracting party. In this section, clauses such as National Treatment and Most Favoured Nation Treatment are commonly found, compelling contracting States to provide foreign investors from the other party the same treatment as accorded to national investors and investors from third States which are not parties to the treaty. Other common standards include Fair and Equitable Treatment, Full Protection and Security and Expropriation rules. Finally, the agreement will generally contain a Dispute Settlement Mechanism, anticipating a possible breach of the obligations established in the treaty.

Precisely, the possibility for the investor (a non-party to the treaty) to activate the Dispute Settlement mechanism becomes one of the highlights of the Investment regime in International Law, whereas, it is for the tribunal, or selected body, to determine whether the State is internationally responsible for the breach of an international obligation.

Since the referred Agreement is a binding convention between two or more States, even in the context of investor-state disputes, its applicable law falls within the scope of international public law. Therefore, whenever there is a breach of the aforementioned obligations, international public law comprehends a set of rules to deal with the State's responsibility for international wrongful acts. This set of rules has been drafted by the International Law Commission on the Articles on State Responsibility.

This document resulted from the compilation of customary rules recognized by the international community. It includes the general principles on State Responsibility, the attribution of a conduct to a State, circumstances precluding wrongfulness, the legal obligation of reparation, and the different forms of reparation to an injury.

The central matter of this thesis will be focused in the circumstances precluding wrongfulness, specifically the state of necessity. Whenever a State is considered to have acted in one of these situations: consent, self-defence, countermeasures, force majeure, distress or necessity, it will not be held internationally responsible, even if it did breach an existent obligation.

In the context of international investment disputes, the most frequently alleged defence is necessity, which is set out in Article 25 of the 2001 Articles on State Responsibility

(International Law Commission, 2001). This circumstance was alleged by Argentina in various cases where investors considered that the State had breach the obligations under particular BITs.

In the decade of 1990, Argentina entered into various International Investment Agreements with the purpose of giving its national economy an international input. The Argentinean government pegged the peso to the dollar and other measures were taken following the guidelines of the International Monetary Fund. Gas and other State industries were privatized, and with the level of protection offered by the treaties signed, foreign direct investment flowed into the economy at an increasing rate. By 2001, given different political, economic and social factors, which will be analysed further, the Argentinean economy entered into a period of recession. The economic distress reached a profound magnitude, which led the government to take several measures, affecting directly foreign investors, particularly those, related to the gas industry. Gas distribution tariffs were converted into pesos, breaching the initial agreement made by the Government to potential investors that such tariffs were to be calculated and paid in dollars. Furthermore, the currency was liberated from the dollar and regulation changed abruptly.

Several foreign investors activated the dispute settlement mechanism contained in the BIT, particularly the United States-Argentina BIT, arguing the State had breached, amongst others, the obligations of fair and equitable treatment and the prohibition of indirect expropriation without prompt, adequate and immediate compensation. The government of Argentina asserted the national economy was under collapse, which caused grave and imminent peril to the State, and therefore Argentina alleged that it was not liable for the measures taken even if they had breached the obligations contained in the treaty.

Argentina has had more than 60 claims before international tribunals due to the actions taken to soothe the economic and financial crisis. However, for the purposes of this analysis we have decided to assess six outstanding decisions, given that they adjudicate on the same facts under the same bilateral investment treaty and have been reviewed by annulment committees, calling the attention of the application of the State of Necessity defence under international investment law. The well-known cases analysed by the International Centre for the Settlement of Investment Disputes (ICSID) on this particular topic are: CMS, Sempra, Enron, LG&E and Continental Casualty. While under the United Nations Commission on International Trade Law (UNCITRAL) arbitration rules the BG case analyses the same issue. All of these proceedings reached different conclusions on Argentina's state of necessity. The tribunals initially differed on the applicable law to the dispute, given that some considered the situation had to be analysed under the rules of Customary International Law (CIL), others determined that Article XI of the USA-Argentina BIT created a special treaty regime, others asserted that article XI reflected Customary International Law and others decided to apply International Trade Law. Nevertheless, all of these cases make reference to the requirements under Customary International Law in order to preclude the wrongfulness of the State actions due to necessity.

Given the present global scenario, it is important to reflect upon the topic of state of necessity in situations of economic distress, especially nowadays given the increasing number of International Investment Agreements signed per year and the varying economic climate affected by worldwide phenomena. That is why this thesis has the particular objective of analysing within the context of international investment disputes the applicability of the state of necessity defence in Customary International Law to an economic distress scenario.

For that purpose, it is important to begin by presenting a review on the state of necessity under customary international law, that is, its concept, elements, and development through judicial decisions and compilation of rules. Subsequently, a close examination will be made on the facts surrounding Argentina's economic crisis of 2001, determining the economic, social and political factors that boiled the outburst of the system. The following chapter will analyse each of the elements and requirements of the state of necessity against the facts that took place in Argentina, taking into consideration the assessment made by the different tribunals and some academic opinions upon it.

The central idea is to consider the viability of a state of necessity in international investment law under the criteria set out by international public law, using Argentina as a case study. Even though, various academic papers have dealt with the matter, such studies have focused on the inconsistency in the outcome of the awards, but this thesis will concentrate on determining whether the Customary International Law criteria must be a given standard in investment law disputes or whether economic distress cases shall be assessed under different principles.

Depending on the outcome of this research, conclusions will be made on whether or not the international investment regime can work with CIL criteria on state of necessity as a circumstance to preclude wrongfulness when breaching international legal obligations and whether new or different elements must be fulfilled.

## CHAPTER I   STATE OF NECESSITY

### 1.1. Some Remarks on International State Responsibility

Within the international relations discipline, and with the purpose to assure the effectiveness of international law among its principal subjects, a set of rules has been developed for those scenarios where a State infringes a legal obligation owed to another State or the international community. It does not matter if this obligation derives either from a treaty provision, custom, a *jus cogens* or *erga omnes* rule, a general principle of international law or even from a unilateral act. Regardless of its source, whenever a State violates a legal obligation, it must be held accountable for it and as a consequence it must provide reparation for the injured State.

In other words, it is accepted that a breach of an international obligation gives rise to a reparation duty. *"Responsibility is the necessary corollary of a right. All rights of an international character involve international responsibility. If the obligation in question is not met, responsibility entails the duty to make reparation."* (Spanish Zones of Morocco Claims, 1925, p. 641.)

As it has been asserted by the Permanent Court of International Justice, the International Court of Justice, in the Nicaragua and in the Gabčíkovo-Nagymaros Case (Nicaragua, Merits, 1986, p. 14, at para. 142);(Gabčíkovo-Nagymaros Project [Hungary v. Slovakia], Merits, 1997, p. 38, at para. 47.) and reiterated by highly qualified publicists, such as the late Ian Brownlie and Malcolm Shaw (Brownlie, 2003, p. 420); (Shaw M., 2008, p.778), State responsibility can be considered and catalogued as a general principle of international law that sets out the legal consequences for the commission of international wrongful acts. *"It is a principle of international law that the breach of an engagement involves an obligation to make reparation in an adequate form. Reparation therefore is the* *indispensable complement of a failure to apply a convention and there is no necessity for this to be stated in the convention itself."*(Chorzow Factory Case [Merits], 1928, p. *29.*)

Thus, as a corollary of international law, and through the State practice and the *opinio juris* not only from States but also from the international community, the law of State responsibility evolved into a set of basic rules and general conditions denominated secondary rules. These provisions, the majority of them considered international customary law, have been embodied by the International Law Commission of the United Nations in the Articles on State Responsibility (the "ILC Articles"), which were adopted by the General Assembly in Resolution 56/83 of December 12, 2001 and later commended in Resolution 59/35 of December 16, 2004.

Although this document has not been enshrined in a convention and sometimes it is recalled as soft law, the general principles on State responsibility, its elements and the circumstances precluding wrongfulness (including state of necessity) have been recognized as customary international law. (Aust, 2005, pp. 407-408); (Gabčíkovo-Nagymaros Project [Hungary v. Slovakia], Merits, 1997, p.7 at para. 40.)

In accordance with customary international law, reflected in PART I of the ILC Articles, in order for a State to be held internationally responsible, the following requirements must be met:

i) The existence of an enforceable obligation towards the breaching State.

ii) The violation of such obligation, which is going to be determined by the obligation itself, or the source where is contained therein. (The Wrongful Act.)

iii) That the wrongful act is attributable to the State.

iv) An actual or future damage to the injured state.

However, the existence of an actual damage or loss, is not always an essential requirement, except if the obligation or primary rule demands it. (United Nations, International Law Commission, 2001, Articles 1-3); (Aust, 2005, p. 410)

Notwithstanding the above, the law on State responsibility considers certain events that justify the commission of an international wrongful act by a State, scenarios where the State's behaviour, although is wrong, it is understandable and excusable. These circumstances have been exposed in Chapter V of the ILC articles and are deemed to have a general application to any international wrongful act committed by a State. Nonetheless, it must be noted that these defences are not applicable whenever the wrongful act is not in conformity with a peremptory norm or whenever there is a *lex specialis* prohibiting its application, e.g. in a treaty. (United Nations, International Law Commission, 2001, Article 26)

As previously mentioned in the Introduction, the circumstances precluding wrongfulness are: consent, self-defence, distress, force majeure, counter-measures and necessity. However two remarks must be noted. Firstly, the burden of proof of the circumstance precluding wrongfulness relies on the State that is alleging it, that is, to the State that is seeking to avoid responsibility. (Aust, 2005, p. 16) Secondly, the main effect of these defences is to justify the wrongful act, not to terminate the international obligation. In order words, once the circumstance precluding wrongfulness no longer exists, the breaching State must abide by the international commitment. "*The circumstances in chapter V operate as a shield rather than a sword.*" (International Law Commission, 2001, p. 71)

Having a general picture of the law on State responsibility, a further study will be carried out in relation to the essential defence analysed in this thesis: the state of necessity.

### 1.2. Concept

Based on the findings made by the International Law Commission, both doctrine (Shaw, 2008, p. 798) (Boed, 2000, p. 13) and the jurisprudence from the International Court of Justice (Gabčíkovo-Nagymaros Project [Hungary v. Slovakia], Merits, 1997 , at para. 52) concluded that the draft of article 33, currently article 25, “reflects customary law”. “*Thus, it seems reasonable to accept the current Article 25 as a statement of the customary international law of necessity, albeit, with the recognition that there is room for disagreement about the precise boundaries of the doctrine at is furthest reaches, and of course in its application in any given case.”* (Muchlinski, Ortino, & Schreuer, 2008, p. 474)

Therefore, as provided in Article 25 of the ILC Articles:

“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*.”

This defence has an exceptional character as an element of its essence, that is, it is an extraordinary event in which an essential interest of the State collides, has an irreconcilable conflict with an international obligation owed to another State or to the International Community, but, the State will only able to breach such obligation if it meets the severe requirements laid down by customary international law as it will be explained below.

Furthermore, from all the other circumstances precluding wrongfulness, it differs, due to the fact that unlike self-defence, consent and countermeasures it is not dependent on the prior conduct of the injured State. (International Law Commission, 2001, p. 80) Also, it differs from force majeure to the extent that the latter, refers to unforeseen events that are out of control of the State, therefore it is impossible for the State to fulfil the obligation. While, in the state of necessity defence the State VOLUNTARILY breaches the obligation at hand, excused in the circumstance that it is the "only means" to safeguard an essential interest of the State.

### 1.3. Development

The concept of necessity has a particular development in international public law; it has experienced a process that attempts to create uniform binding rules throughout the judicial decisions issued by several international tribunals. This process is reflected in the ILC Articles endorsed by the General Assembly of the United Nations, which will be described in the following paragraphs.

#### *i) Origin of the International Law Commission*

The progressive development of international law between various agents, produced the initiative of creating international binding codes with global applicable rules for different issues. A significant number of diplomatic conferences were engendered by draft codes and proposals that were prepared by the Institut de Droit International (1873), the International Law Association (since 1873) and the Harvard Research in International Law (1927). (Historical Survey of the Development of International Law, 1947); (Outline of the Codification of International Law in the Inter-American System, 1947)

As the idea of establishing general rules broadened, States concluded various covenants; however these treaties dealt with isolated topics and particular problems, for instance, war matters were specifically discussed in The Hague Peace Conferences of 1899 and 1907.

On September 22, 1924 the League of Nations resolved to create a body named The Committee of Experts for the Progressive Codification of International Law, composed by members who represented the principal legal systems in the world. (League of Nations Official Journal, p. 10) Later, in 1927, a conference was organized to discuss and possibly codify three important matters which were considered ripe enough to create general rules: (1) nationality, (2) territorial waters and (3) the responsibility of States for damage inflicted in their territory to the person or property of foreigners.

Subsequently, after World War II, with the creation of the United Nations a more express and binding commitment on the development of international law and its codification was instituted. Indeed, paragraph 1 of article 13 of the United Nations Charter empowered the General Assembly to promote this purpose: "*The General Assembly shall initiate studies and make recommendations for the purpose of: a. promoting international co-operation in the political field and encouraging the progressive development of international law and its codification....*" (Charter of the United Nations, 1945). To achieve this goal, the General Assembly appointed a Committee which held meetings in 1947 and through a report recommended the establishment of an international law commission. (Official Records of the

General Assembly, 1947) Pursuant to this report, the General Assembly adopted Resolution 174 (II) of 21 November 1947 establishing the International Law Commission and approving the ILC Statute.

### *ii) History of Articles on State Responsibility and the issue of necessity*

Since 1923, the League of Nations' Committee was dedicated to the analysis of various topics in international law, amongst them, given the high level of acceptance of its common rules, State Responsibility became one of them. The first approach from this committee was focused primarily on the responsibility of States limited to the context of injuries committed to aliens.

Afterwards, in 1955 the International Law Commission appointed García Amador as Special Rapporteur to investigate about State Responsibility. A year later, he produced his first report including a section on 'exoneration from responsibility and attenuating and aggravating circumstances', which comprised defences such as necessity and force majeure. Later on, in 1957, García Amador, in its second report, admitted that the non- performance of obligations do not generate liability if it were justified on grounds of public interest or of economic necessity of the State. (Muchlinski, Ortino, & Schreuer, 2008, p. 467)

In 1961, the ILC determined that the research scope on treatment to aliens was too narrow and extended the investigation to general international responsibility. Then, in 1971 Roberto Ago handed the first report laying out the general principles and attribution on State Responsibility.

In relation to necessity as a defence, in 1979, in its eight report the ILC presented article 33 which stated:

*"1. A State of necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act of that State not in conformity with an international obligation of the State unless:(a) The act was the only means of safeguarding an essential interest of the State against a grave and imminent peril; and (b) The act did not seriously impair an essential interest of the State towards which the obligation existed. 2. In any case, a State of necessity may not be invoked by a State as a ground for precluding wrongfulness:(a) If the international obligation with which the act of the State is not in conformity arises out of a peremptory norm of general international law; or (b) If the international obligation with which the act of the State is not in conformity is laid down by a treaty which, explicitly or implicitly, excludes the possibility of invoking the State of necessity with respect to that obligation; or (c) If the State in question has contributed to the occurrence of the State of necessity."* (Ago, 1979)

Furthermore, in the same year, Professor Ago published an addendum dealing exclusively with the necessity defence, which was only submitted along with the eighth report in 1998, for the examination of States.

In 1997, James Crawford was appointed Special Rapporteur, introducing important changes to article 33. Basically, the new draft of current Article 25 modified section 2 (b), in order to include general sources of international law and not just treaties. Moreover, this article included the scenario not only of the impairment of the essential interest of another State but also the impairment of an essential interest of the international community. Furthermore, the rule which states that necessity may not be invoked in cases whenever the breach of obligations contravenes *ius cogens* or peremptory norms is separated in a single article which applies to all circumstances precluding wrongfulness.

Finally, in 2001, the ILC adopted the text that embodied the draft articles on State responsibility and submitted it to the General Assembly of the United Nations, which were adopted by this organism in Resolution 56/83 of December 12, 2001 and later commended in Resolution 59/35 of December 16, 2004.

As stated previously in section 1.1 of this chapter, although this document has not been enshrined in a convention and sometimes it is recalled as soft law, the state of necessity defence has been recognized in the Gabčíkovo-Nagymaros case as customary international law. (Gabčíkovo-Nagymaros Project [Hungary v. Slovakia], Merits, 1997, p.7 at para. 40.)

### *iii) Judicial decisions and International Court of Justice*

It is important to take closer look to the relevant judicial decisions that have examined the issue of necessity as a circumstance precluding wrongfulness. Tribunals and courts have dealt with necessity even before the creation of judicial bodies such as the Permanent Court of International Justice and the International Court of Justice. The most recent analysis of necessity is elaborated by the Investment Tribunals that have decided the cases of investor-state disputes against Argentina. The latter will be explored in Chapter 3, while this section will go into the cases that served as a base in international public law for the subject of necessity.

#### *a. <u>Neptune Case</u>*

In 1797, the Neptune, a vessel on voyage from Charleston, United States to Bordeaux, France, was seized by British authorities because the ship was considered to be heading enemy port. Afterwards, proceedings were commenced in London before the High Court of Admiralty.

The Court ordered the vessel to sell the cargo to the British government by the value of the invoice plus a 10% profit. The claimant (Neptune) applied to the Board of Commissioners under article 7 of the Jay Treaty seeking compensation for the difference between the value obtained in London and the expected value to be obtained in France. At the time, Great Britain was at war with France and thus Britain argued that the vessel was approaching enemy port, which was to be considered as war contraband. Moreover, the respondent added that its actions were precluded from wrongfulness due to a state of necessity because the articles seized were scarce.

An American commissioner, William Pinkney, stated the following:

*"I shall not deny that extreme necessity may justify such a measure. ... We are told by Grotius that the necessity must not be imaginary, that it must be real and pressing, and that even then it does not give a right of appropriating the goods of others until all other means of relief consistent with the necessity have been tried and found inadequate. Rutherforth, Burlamaqui, and every other writer who considers this subject at all will be found to concur in this opinion."* (Yamada, State of Necessity in International Law: A Study in International Cases, 2005, p. 113)

Even when the Commissioners of the Board recognized the possibility of necessity as a valid defence, they did not accepted Britain's plea, because it considered that in this particular case the circumstances alleged by Britain were not extreme enough to be considered as necessity. Additionally, it was stated that the British authorities had neither evaluated the other State's interests nor they calculated the extent of their necessity situation. The Neptune case shows that necessity was examined in judicial proceedings during the eighteen and nineteenth century, and consequently is not the case of a new concept.

### b. Russian Indemnity Case and Serbian Loans Case

The Russian Indemnity Case in 1912 (Permanent Court of Arbitration) and the Case concerning the payment of various Serbians Loans issued in France case of 1929 (Permanent Court of International Justice), illustrate how economic necessity has been a constant defence alleged by States in international disputes. In the former, the Ottoman Empire justified its delay in the repayment of a debt to the Russian government by stating it was experiencing a difficult financial situation. This court adopted the theory that compliance with the international legal obligations must result self-destructive in order to preclude wrongfulness if they are breached, and thus the economic scenario did not provide that situation. In the latter case, France took proceedings on behalf of its nationals asserting that the Kingdom of the Serb-Croat Slovene was obliged to pay the sums owed to its nationals on the basis of the gold franc. The respondent alleged that the economic crisis caused by the First World War had led to the necessary breach of obligations: *"Force majeure – It cannot be maintained that the war itself, despite its grave economic consequences, affected the legal obligations of the contracts between the Serbian government and the French Bondholders. The economic dislocations caused by the war did not release the Debtor State*." (Case concerning the payment of certain Serbian Loans issued in France, 1929, p. 39) Although the defence was presented as force majeure, the Kingdom of the Serb-Croat Slovene stressed that compliance with the obligation would have jeopardized an essential interest. Although theses tribunals did not rule in favour of the respondent States, the abovementioned decisions reflect that years before international investment tribunals were created, States and investors considered that economic and financial circumstances affected a State's compliance with international obligations.

### c. <u>*Rainbow Warrior Affair*</u>

In 1985, the Rainbow Warrior, a civilian vessel, was sunk by explosive devices in Auckland Harbor, New Zealand. One person was killed as a result of the incident. Later on, two agents of the French Directorate General of External Security were arrested and prosecuted. The agents pleaded guilty in the District Court of Auckland, and were sentenced to 10 years of imprisonment. In 1986, the governments of France and New Zealand approached the Secretary General of the United Nations, seeking a binding ruling on the Rainbow Warrior Affair. The Secretary General, amongst other aspects, ordered the transfer of both agents to a French military facility on an isolated island prohibiting their exit unless authorized by both governments. Both prisoners left the island before their period ended.

An arbitral tribunal was created and France opposed to all claims asserting officers left the island due to distress, force majeure and necessity. The tribunal stated: *"Under article 32, on distress, what is "involved is situations of necessity" with respect to the actual person of the State organs or of persons entrusted to his care, and not any real 'necessity' of the State. On the other hand, Article 33, which allegedly authorizes a State to take unlawful action invoking a state of necessity, refers to situations of grave and imminent danger to the State as such and to its vital interests. This distinction between the two grounds justifies the general acceptance of article 32 and at the same time the controversial character of the proposal of article 33 on state of necessity."*(Rainbow Warrior Affair, 1990, p. 554-555)

Contrary to the general acceptance of the necessity defence in other judicial decisions and in the view of highly qualified publicists, this tribunal qualified the necessity defence as 'controversial'. Even though the tribunal did not reject the idea of necessity as a defence, it called upon its convenience in the international legal system.

*d. Gabcíkovo – Nagymaros (1997)*

In September 16 1977, Hungary signed the Budapest Treaty with Czechoslovak People's Republic for the construction and operation of the Gabcíkovo-Nagymaros system of locks in an area of the Danube River. In 1989, Hungary suspended and abandoned the construction and operation of the dam. Slovakia (independent State since 1993) presented the claim before the International Court of Justice. Hungary relied on the necessity defence, and expressed that the continuation of the project entailed great risks to Hungarian environment and specifically to water supply in Budapest. It is important to highlight that Hungary acknowledged its obligation to compensate for any damages.

For the first time, an international judicial organ recognized necessity to be customary international law: *"The Court considers, first of all, that the state of necessity is a ground recognied by customary international law for precluding the wrongfulness of an act not in conformity with an international obligation*." (Gabčíkovo-Nagymaros Project [Hungary v. Slovakia], Merits, 1997, p. 40) Another highlight of this decision is the fact that the court recognized the possibility of ecological damage justifying the invocation of necessity.

The Court concluded that the ecological damage did not seem to be imminent and therefore necessity was not accepted. Additionally, Hungary had other means available, other than the suspension and abandonment of the works, of dealing with ecological damage.

*e. M/V Saiga No. 2*

In 1997, the oil tanker M/V SAIGA flying the Saint Vincent and Grenadines flag was arrested on the coast of West Africa by Guinean patrols. Guinea alleged the ship was engaged in smuggling activities.

The International Tribunal for the Law of the Sea stated that there was no evidence produced by Guinea to show that its essential interests were in *'grave and imminent peril'*. Additionally, it stated that Guinea's 'essential interest' which consisted in increasing its tax revenue from the sale of gas oil to fishing vessels, could be safeguarded by other means rather than extending its customs law to parts of the exclusive economic zone. (Yamada, State of Necessity in International Law: A Study in International Cases, 2005, pp. 191-192)

*f. Legal consequences of the construction of a wall in the occupied Palestinian territory, Advisory Opinion*

On December 2003, the UN Secretary-General communicated to the ICJ the decision taken by the General Assembly to submit the question set forth in its resolution, adopted 8th December 2003 for an advisory opinion. The question, in essence, was: What are the legal consequences arising from the construction of a wall by Israel in the occupied Palestinian territory?

The Court found the construction of the wall to be illegal, contravening customary international law and various treaties to which Israel is party. It analyzed whether Israel's actions could be justified by the exception of a state of necessity. *"In the light of the material before it, the Court is not convinced that the construction of the wall along the route chosen was the only means to safeguard the interests of Israel against the peril which it has invoked as justification for that construction."* (Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory, 2004, p. 88)

*g. Oil Platforms*

In the Persian Gulf, between 1980 and 1988 an armed conflict took place between Iraq and Iran known as the "Tanker War", in which Iraq commenced attacks against ships carrying Iranian Oil. The dispute is around two specific attacks on shipping: in 1987 near

Kuwait harbour, a missile hit the Kuwaiti tanker Sea Isle City. The United States attributed this attack to Iran, and three days later, it attacked two Iranian offshore oil production installations in the Reshadat complex. The second attack was in 1988, the warship USS Samuel B. Roberts struck a mine in international waters near Bahrain while returning from an escort mission; four days later the United States employed its naval forces to attack and destroy simultaneously the Nasr and Salaman complexes. As a consequence Iran seized the Court on 2 November 1992 against the United States for the attacks and destruction of three offshore oil production complexes. The Court concluded that although US defences were not to be accepted, US behaviour did not breach the treaty between US and Iran. The US opposed to Iran's arguments using a specific defence contained in the treaty that had the characteristics of self-defence. However the issue of necessity was implicitly treated. "*On the basis of that provision, a party to the Treaty may be justified in taking certain measures which it considers to be "necessary" for the protection of its essential security interests. As the Court emphasized, in relation to the comparable provision of the 1956 United States - Nicaragua Treaty in the case concerning Military and Paramilitary Activities in and against Nicaragua, "the measures taken must not merely be such as tend to protect the essential security interests of the party taking them, but must be 'necessary' for that purpose"; and whether a given measure is "necessary" is 'hot purely a question for the subjective judgment of the party" (I. C.J. Reports 1986, p. 141, para. 282), and may thus be assessed by the Court.* (Oil Platforms, Preliminary Objections, 1996, p. 72)

### 1.4. Elements

With the purpose of avoiding abuses from States in the use of this plea, as mentioned previously, the State must fulfil CUMULATIVELY certain requirements expressed in Article 25 in order to preclude the wrongfulness of its breach. As stated by Andrea K. Bjorklund: *"A State must first meet certain affirmative requirements in order to establish the basis for* *raising the defence; next it must show that none of the exceptions to the defence's applicability applies. Moreover, the requirements are cumulative.*" (Muchlinski, Ortino, & Schreuer, 2008, p. 475)

*i) Positive Formulations*

*a. <u>Essential interest of invoking State</u>*

The ILC discussed the possibility of laying down a definition of what should be understood as "*essential interest".* Earlier on, it was clear that essential meant a vital interest of the State, however it was not only circumscribed to the existence or continuance of the State, e.g. a political, environmental or economic crisis was considered as an essential interest for the State.

Nevertheless, as it is evidenced in the commentaries on the ILC Articles, Professor Crawford desisted from a general definition of essential interest and noted that it must be determined based on a case to case scenario: "*'Essential' depends on the circumstances, cannot be prejudged"* (International Law Commission, 2001, p. 83)

*b. <u>Grave and imminent peril</u>*

Moreover, once the essential interest is under the scope of protection of the breaching State, this interest needs to be under grave peril, meaning seriously threatened. Now, such circumstances of risk or danger are to be objectively established. No State can self – determine the peril under which its essential interest is. (Shaw M. , 2008, p. 798)

Also, the most relevant feature of these circumstances of danger is that they must be proximate, as stated by the International Court of Justice in the Gabcíkovo - Nagymaros Case: "..."*Imminence" is synonymous with immediacy or proximity and goes far beyond the* *concept of possibility".* (Gabčíkovo-Nagymaros Project [Hungary v. Slovakia], Merits, 1997, at para. 54).

*c. "Only means"*

Perhaps one of the most demanding of all affirmative requirements, mainly because the State must assess all the means it has in order to save its essential interest from peril. If there is another way out, even a more costly one for the State, and it isn't carried out, in no way is justifiable is international wrongful act. "*It is required that the acting State had no alternative but to engage in the unlawful conduct*." (Boed, 2000, p. 17)

*d. Impairment of essential interests of other states or international community*

Whenever we are before bilateral contexts i.e. in situations where the interests of two states are directly in conflict, it is a matter of balancing the essential interest at stake. Here, the State alleging the necessity plea must prove that the interest of the international community, or of the other State had lesser importance and that the sacrifice was done for a greater cause represented in the essential interest at hand that was sought to save. (International Law Commission, 2001, p. 45)

*ii) Negative formulations (Exceptions)*

*a. International obligation in question precludes the use of defence*

The law on State Responsibility referenced in the ILC articles has a residual character, in other words is binding unless otherwise provided by *lex specialis* whenever an international instrument prohibits the necessity defence, it doesn't matter if the remaining requirements are met, it cannot be raised. (Aust, 2005, p. 691) *b. State has contributed to the situation of necessity*

This requirement is a manifestation of the general principle of international law, in which no State can benefit from its own wrongful acts, also known as the clean hands doctrine. If the State contributes to substantially and not merely incidental or peripherally to its scenario of grave and imminent peril it cannot make use of this plea. (International Law Commission, 2001, p. 84)

*c. Ius cogens*

Last but not least, is the prohibition from article 26[1] of the ILC Articles which reiterates the very nature of *ius cogens* norms, provided that there is no possibility for an internationally wrongful act which results from the breach by a state of an international obligation so essential for the protection of fundamental interests of the international community to be justified. (Shaw M. , 2008, p. 807)

1.5. Other Sources

After a detailed description of the state of necessity developed by customary international law, a brief remark must be made on the fact that, this defence can be invoked from various sources of international law. In other words, although this defence is invoked principally through the ILC articles - subject matter of this thesis - it can also be established as treaty-based defence.

As a matter of fact, the ILC Articles must be considered, not as a general rule of law, but rather as a secondary rule that applies whenever the primary rule or *lex specialis* do not provide any rule on the matter. For instance, multilateral treaties such as the General

[1]*Article 26: Nothing in this chapter precludes the wrongfulness of any act of a State which is not in conformity with an obligation arising under a peremptory norm of general*

Agreement on Trade and Tariffs of 1947 (GATT), in the context of the international trade law regime, sets forth in Article XXI the “essential security exception”.

This article opens the possibility for the State, to perform acts that under general circumstances may be interpreted as a breach to the treaty, but in such specific scenarios and meeting particular requirements provided by the articles, the State action remains as a justifiable act: *e.g. “for the protection of its essential security interest”.* (Álvarez & Brink, 2010, p. 22)

Another example may be seen within the articles contained in Bilateral Investment Treaties (BITs), and Investment Chapters of Free Trade Agreements (FTAs). For example Article XI from the Argentina-US BIT, establishes, what it is commonly known as Non – Precluded Measures (NPM).

Nevertheless, in the following Chapters this thesis will address the analysis made by the different tribunals, on whether the BIT provisions dealing with the defences refer to same state of necessity defence of the ILC Articles, or if they constitute totally different exceptions that a State may invoke to preclude its international responsibility.

Now that a general picture of the state of necessity defence has been exposed, we will move forward to the factual scenario that triggered Argentina’s economic crisis and led the South American State to violate the provisions of the US-Argentina BIT and UK- Argentina BIT.

# CHAPTER II ECONOMIC CONTEXT OF ARGENTINA IN 2001

Having reviewed the general idea and development of state of necessity in the framework of the responsibility of States for international wrongful acts, it is now the moment to give a brief account of the complex situation that took place in Argentina by 2001. As mentioned earlier, the idea of this thesis is to elaborate conclusions on the application of the state of necessity defence developed by customary rules of international law to scenarios of economic distress in general, taking the Argentinean experience as a case-study. Although certain causes and effects of an economic crisis are global notwithstanding the geographical area, history or political regime of a country, it is important to analyse particular circumstances in order to obtain more accurate conclusions on the topic.

The expression 'Argentina's economic crisis' usually brings up images of social disturbance and numbers of financial deficit. However, the state of affairs in December 2001 is only the outcome of a chain of interrelated events which led to absolute distress in the country. The picture presented below, nourished by various sources, briefly describes Argentina's economic history throughout the XX century, as a prelude of the events that took place during 2000 and 2002.

## 2.1.2001: Total Unrest

It was December of 2001; the unemployment rate was 21.5%, a massive flight of capital took place, bank accounts were blocked, the external debt reached 135 billion dollars, the Argentinean peso lost 40% of its value in one day, starvation attacked the most vulnerable sectors of the population and insurrection exploded. After two years of government, President De la Rúa was forced to resign after dismissing the people's demand for change. His progressive program was replaced by the plans of multilateral economic organizations such as the International Monetary Fund. *"If budget profligacy or corruption was not the problem,* *what was? To understand what happened in Argentina, we need to look to the economic reforms that nearly all of Latin America undertook in the '80s. Countries emerging from years of poverty and dictatorship were told that democracy and the markets would bring unprecedented prosperity. And in some countries, such as Mexico, the rich few have benefited."* (Stiglitz, 2002, p. 2)

In order to understand the conditions that boiled such situation, it is essential to go back in history and perceive the different social, political and economic phenomena. J.F. Hornbeck states in his CRS Report: "*Argentina's current crisis resulted from a confluence of events, some external to Argentina's policy process, others directly related to its political and economic choices. Although it is not easy to discern at what specific point in time Argentina's economic situation has turned into a crisis, it is clear that by early 2001, political, economic and social events had taken a significant turn for the worse."* (Hornbeck, 2002, p. 1)

The disastrous picture of Argentina by the end of the 20$^{th}$ century strikes as a surprise if we consider the level of endowment with natural resources that the country has always possessed, the position of the Argentinean economy compared not only with other Latin American countries but even with European economies and the general stability that surrounded the State since its independence. *"Even before the latest disaster, Argentina's story is that of a decline unparalleled in modern times. Blessed with some of the world's most fertile land on the endless pampas, Argentina in the 19th century attracted a flood of British capital and European immigrants. By 1913, having grown at an annual average rate of 5% for the previous three decades, it was one of the world's ten richest countries, ahead of France and Germany."* (Argentina's Collapse: A Decline Without Parallel , 2002)

### 2.2. Everlasting Debt

In the beginning, Argentina's main problem was the fiscal imbalance that was subject to. Whenever the agricultural products prices crashed, and the exportation of beef and grain was not enough to support its economy, the governments throughout the 20th century covered the deficit budget by printing more money.

This governing habit of rescuing the economy through the printing press turned out to be highly destructive along the different presidential mandates and got Argentina in an untenable foreign debt. (Krugman, 2009, p. 30)

Argentina's first loan was obtained from an English bank in 1824. Since that moment, the country's record in borrowing is shocking. Particularly during the military dictatorship, Argentina acquired massive debt (45 billion dollars), which was supposed to finance projects for national infrastructure. The rise of oil prices in the 70's and 80's forced most of the developing countries in Latin America to acquire external debt.

However, private debt also had an alarming number in the country. There was an Argentine Law that provided that parent companies were responsible for the debts of their subsidiaries. Nevertheless, no one complied with this provision and during the crisis; the State had to provide for private debt as well. By 2001, the debt reached more than 130 billion dollars. (Hornbeck, 2002)

### 2.3. From prosperity to deficit (A Political Glimpse)

*i) The Peron Era:*

The populist leader, Juan Domingo Perón, was Argentina's elected president for three periods. The first period was from 1946 to 1952. During his mandate, amongst other things, he included a series of social and labour rights into the constitutional text, paid close attention to the subject of education, and supported a law which allowed women to vote for the first time. On the economic side, he adopted the policy of substituting imports in order to impulse local industries. *“But Argentina's leaders, starting with Juan Domingo Peron, a populist army colonel who ruled from 1946 to 1955, aggravated their country's problems by retreating into protectionism and financing generous benefits to workers by printing money. Four decades of political and economic instability culminated in the restoration of democracy in 1983.”* (Argentina's Collapse: A Decline Without Parallel , 2002) His second period started in 1952 and ended in 1955 with a military coup d’état. He returned in 1973 after exile in Spain and died in 1974, his wife and vice president María Estela Martínez de Perón took office.

*ii) The Junta*

Another highlight of Argentina’s governments during the 20th century is the establishment of a military dictatorship since 1976 until 1983. During this era, a sequence of presidents from the armed forces took office. It was a period of censorship, repression, massive violations of human rights, forced disappearances, illegal arrests and extrajudicial executions. On economic policies the *junta militar* adopted a strategy of external borrowing and neoliberal inclination.

*iii) Alfonsin’s epoch (1983-1989)*

Raúl Alfonsín was the first elected president after the Junta Militar. Since he became head of State he used different speeches on the government’s position towards external debt, sometimes stating Argentina was not going to borrow any more money and other times arguing on the need of increasing the debt. He introduced monetary adjustments by making significant cuts on the government expenditure. On the political aspect, during his mandate the members of the Junta Militar were prosecuted and convicted. However, the congress enacted a very controversial law which established that the individuals who acted under orders of the political and military leaders in the era of the Junta were not to be prosecuted. Alfonsin resigned.

*iv) The Menem Decade:*

In 1989, Carlos Menem is elected President and Domingo Cavallo is appointed Minister of Economy. "*Together they enact a major structural adjustment program including tax reform, privatization, trade liberalization, deregulation, and adoption of a currency board."* (Hornbeck, 2002) This is perhaps the moment in Argentina's economic history where the scenario becomes particularly relevant for investors affected by the crisis in 2000 and 2001. The decisions taken by Menem in terms of economic turn point, trade, privatizations and politics became essential for the creation of a melting pot of circumstances that later exploited against investors, citizens and authorities. *"In 1989 Argentina took economic measures to reduce inflation and the public deficit. Act 23.696 of 17 August 1989 provided, inter alia, for the privatization of certain state owned companies, including the gas transportation and distribution monopoly Gas del Estado, Sociedad del Estado (Gas del Estado). Almost two years later, Law 23.928 of 27 March 1991 (the Convertibility Law) established a 1 to 1 fixed parity between the Argentine peso and the US dollar."*(BG Group Plc. v. Argentine Republic. Final Award, 2007, p. 17)

One of the fundamental decisions taken by the government during the Menem period was the adoption of a convertivility plan. The Argentinean currency, the Peso, was pegged to the United States' dollar. In that scenario, a dollar was worth one peso. *"April 1 1991 - Argentina's Congress enacts the Convertibility Law, which legally adopts the currency board guaranteeing the convertibility of peso currency to dollars at a one-to-one fixed rate and limiting the printing of pesos only to an amount necessary to purchase dollars in the foreign* *exchange market. Effectively, each peso in circulation is backed by a U.S. dollar and monetary policy is forcibly constrained to uphold that promise*." (Hornbeck, 2002) This measure opens up the Argentinean economy to imports. Before the convertibility plan, 95% of the goods purchased in the country were locally produced or obtained. However, with the new monetary policy, demand increased for imported goods, and thus local industry started to disappear. The entire country was dollarized, since goods and services could be purchased in both Pesos and dollars.

At first, the Convertibility Plan had positive results inasmuch as inflation was significantly reduced. *"Inflation, which was raging at a monthly rate of 27 per cent in February 1991, declined to 2.8 per cent in May 1991; on an annual basis, inflation fell to single digits in the summer of 1993 and remained low (or even negative) from 1994 to the end of the convertibility regime in early 2002."*(Continental Casualty Company v. Argentine Republic. Merits Final Award, 2008, p.46) Additionally, the government's fiscal balance had a positive impact as well.

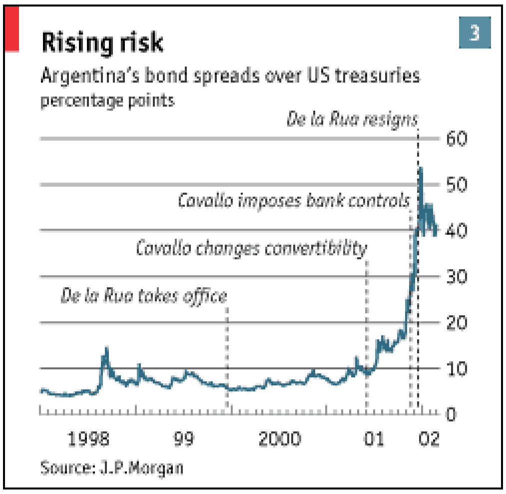
Privatization of various industries and other measures taken also had an initial positive effect, since direct foreign investment entered Argentina's economy at increasing rates. *"Mr Cavallo's scheme seemed to work. After a lag, inflation was killed. With all risk of devaluation apparently removed, capital poured in from abroad. Mr Menem privatised almost everything the state owned, except for a couple of banks. Between 1991 and 1997, Argentina's economy grew at an annual average rate of 6.1%, the highest in the region (see chart I). Productivity increased as investment modernised farms, factories and ports."* (Argentina's Collapse: A Decline Without Parallel , 2002)

Chart I


(Argentina's Collapse: A Decline Without Parallel , 2002)

As Chart I illustrates since 1991 Argentina's economic growth was remarkable. 1995 reveals a bust period due to the effects of the Mexican crisis of 1994. *For 1991-98, GDP growth averaged nearly 6 per cent a year, vindicating the market-oriented reforms introduced in the early 1990s. Attracted by a more investment-friendly climate, there were large capital inflows in the form of portfolio and direct investments.* (Continental Casualty Company v. Argentine Republic. Merits Final Award, 2008, p.46)

The authorities also offered State bonds in order to increase government income and reduce deficit. Nevertheless, lack of confidence and the renowned large debt Argentina owed increased the risk in the acquisition of such bonds. When a State acquires debt through bonds, the risk of not being able to pay its creditors is measured by a comparison to the risk of holding US treasury bonds, which is called the 'spread'. If the spread is high it means that holding a given State's bonds turns to be much riskier than holding US bonds, and therefore that State must offer higher interest rates in order to obtain the credit. Referring to bondholders of the Argentinean government, the economist explains: *"They demanded a higher risk premium for holding Argentine bonds, driving up interest rates and deepening the recession (see chart 3)."* (Argentina's Collapse: A Decline Without Parallel , 2002)




(Argentina's Collapse: A Decline Without Parallel , 2002)

On the political aspect, the convicted leaders of the military dictatorship were pardonned by Menem, which turned to be a highly controversial measure since the *junta militar* had ended a few years before and the memories of the acts committed during such period were still fresh. However, after 2006 several actions were commenced attacking the validity of Menem's decisions towards the trials and sentences. Since the beginning of his period, he developed a close relationship with the United States' government and multilateral economic organizations such as the International Monetary Fund and the World Bank. Internally, the republic began a process of deterioration full of corruption, fraud and instability. However, that did not constitute an obstruction for the re-election of president Menem in 1995, after convincing the Congress to change national laws which forbade a second presidential period.

Argentina entered into numerous international investment agreements, granting broad protection to investors and consenting on the dispute settlement mechanism contained in these instruments. As mentioned earlier, this mechanism allowed investors to take claims against the State to international tribunals. *"During this period, Argentina undertook to provide enhanced legal protection to investors so as to attract foreign investment in support* *of its privatization scheme. The Respondent ratified several treaties relating to international investment obligations, such as the ICSID Convention and a great number of bilateral investment treaties, including the Argentina-U.S. Bilateral Investment Treaty at issue in this dispute. As mentioned above, the Convertibility Law, which pegged the peso to the U.S. dollar, was also enacted at this time."*(LG&E Energy Corp., LG&E Capital Corp. And LG&E International Corp. v. Argentine Republic. Decision on Liability, 2006, p.53)

The legal and economic conditions of the State opened the door to privatizations and to the relaxed entry of foreign investors. On the specific case of natural resources, the parliament gave the ministries extraordinary powers to regulate certain issues. YPF (the national oil company) and Gas del Estado (the national gas company) were privatized under circumstances that later were accused and denounced as bribery. Gas del Estado was divided into transportation companies and distribution companies. Most of the resulting corporations were acquired by foreign investors who were protected by Bilateral Investment Treaties. ENARGAS was created as the regulatory agency in charged with the implementation of gas privatization. *"Pursuant to the Government's privatization plan, investors could purchase shares in newly-formed, licensed private corporations that would offer gas transport and distribution services. Such shares were available to domestic and foreign investors."* (LG&E Energy Corp., LG&E Capital Corp. And LG&E International Corp. v. Argentine Republic. Decision on Liability, 2006, p. 37)

Acts and decrees were enacted regulating the privatization of the gas sector. In article 41 (1) of a decree dated 18 September 1992, the government introduces the US dollar as the currency in which to assess and calculate the value of transportation and distribution tariffs. As Fernando Solanas contended in his documentary film 'Memorias del Saqueo', Argentina is the only State that handed in oil and gas industries to privates without losing a war as the cause of it. (Solanas, 2004)

The reputation of Carlos Menem began to deteriorate since he was involved in an arms smuggling scandal. From that event on, the Supreme Court of Justice of Argentina became known as 'The Court of impunity' because not only Menem, but several other politician's investigations and trials were terminated without any legal support. Additionally, the economy was affected by a serious of external factors and events which were not easy to handle with a pegged currency. *"Starting in 1998, external developments contributed to the demise of the currency regime implemented by, inter alia, the Convertibility Law:*

*a) Capitals stopped flowing to emerging markets following the Asian crisis and the Russian default of 1998;*

*b) Demand weakened in Brazil, one of Argentina's major trading partners;*

*c) The price of Argentina's exports relative to its imports decreased considerably;*

*d) Argentina lost competitiveness abroad as a result of the devaluation of the Brazilian currency and the appreciation of the dollar; and*

e) *Monetary policy was tightened by the U.S. Federal Reserve and 1999 and 2000."*(BG Group Plc. v. Argentine Republic. Final Award, 2007, p.53)

The aforementioned reveals that no matter the benefits in terms of inflation and growth, the Convertibility Plan left the economic authorities with little space and tools to respond to external factors that didn't depend on them. In the end, the effects on the economy were devastating increasing the government's disapproval and feeding revolutionary energies. *"Between 1999 and 2002, cumulative loss of GDP was about 25% and real per capita GDP fell from $8,302 in 1998 to $2,595 in 2002. Public debt and the fiscal deficit increased."*(BG Group Plc. v. Argentine Republic. Final Award, 2007, p. 55

### 2.4. The final decline

In December 1999, with an external debt arising to an amount of USD $121.877 billion, and an unbearable atmosphere of corruption, Fernando De La Rúa of the Radical Civil Union, is elected president under the premises of clearing the mafia from the political power and fighting recession.

Putting an end to the Menem decade and aware that he had inherited an economic crisis, De La Rúa focused on reducing the budget deficit through economic growth, hence it lowered the interest rates in order to spur the economy. However, doubting this measure will reactivate the local market in a short term and unwilling to abandon the convertibility plan, the president together with his Minister of Economy, José Luis Machinea called for a big tax raise.

Simultaneously, the Argentine president sought for the assistance from the IMF, with a three-year $7.2 billion loan, conditioned to the implementation of labour flexibility and to ensure a GDP growth of 3.5% for 2000. Even though the economy continued to shrink in 2000, and the GDP only grew 0.5% this stand by-agreement prevented a bank panic and cushioned the external financing for 2000 and 2001. (Joint Economic Committee Report for the United States Congress)

Later on, on May 2000, with the purpose of regaining confidence and due to the high interests paid abroad in the foreign debt, De La Rúa announced a spending cut of £649 million. However the discontent among officials and argentines triggered protests of more than 20,000 people against these measures, which as a consequence had Machinea's resignation on March 2001. As his successor, De La Rúa appointed Ricardo López Murphy, whose days in office were a couple of weeks, before being replaced by the man of the hour in the Menem’s decade, Domingo Cavallo.

With Mr Cavallo as head of the ministry of economy, a different path was taken. Firstly, convinced that Argentina has been living beyond its means for too long, he introduced the Zero Deficit Law by which the State was obliged to have a balanced budget by the end of 2001 quarter. To achieve this goal Cavallo levied hardly the citizens' income, and implemented the Austerity Plan: all officials who earned more than 1,000 pesos were affected by a wage cut, and 13% from the government spending was effectively slashed. Nevertheless, confidence was not regained; Argentina faced heavy capital and interest payments on its debt in the second semester of 2001.

Secondly, Cavallo intervened with the convertibility plan that himself sponsored in 1991. On April 17, 2001 he introduced a bill to switch the exchange rate link of the peso from the U.S. dollar alone to a 50-50 combination of the dollar and the euro. At the time, the dollar was at its strongest level in about 15 years, and its strength led Argentine exporters and businesses competing with imports to complain that the peso was too strong. (Joint Economic Committee Report for the United States Congress)

However, privatization of certain sectors and the increased rate of foreign direct investment were not entirely positive for the economy. In fact, some industries fell into entire collapse, such as the railway system which went from 36 000 km to 8000 km and very low functioning.

Meanwhile, due to the economic contraction, the capital flows derived from exports had been reduced by half in 2000. Capital markets began to believe that Argentina`s situation was not transitory, to the extent that by 2001 foreign funds weren't disbursed in Argentine banks.

Now, depositors in Argentina beholding this panorama, and fearing that the banks weren't able to collect from their clients, and above all acknowledging the fact that their pesos will not preserve their value in dollars started to pull out their money from their banks accounts. Massive bank runs took place on November 30, 2001, 500 millions of dollars were being withdrawn from the banking system every day, producing a fall of $2 billion dollars in the central bank reserves, thus forcing the government to implement *"The Corralito[2]"*.

With Decree 1570 of December 1, 2001, bank deposits were blocked; the right to withdraw money was curtailed and the transfer of funds from Argentina to other countries was limited. Moreover, the term of certain deposits was modified, extending the period to permit withdrawal and interest rates were significantly reduced from the agreed between banks and citizens.

The economy turned from recession to depression as people and businesses could not make payments. Credit evaporated. Argentines remembered how high inflation had deprived them of the real value of their savings during a similar freeze in 1989 and in a 1982 freeze engineered by Cavallo himself. Many people took to the streets in angry demonstrations called *cacerolazos,* because people banged casserole pots and pans to make noise.

Furthermore, on December 5 the IMF announced it would cease making further instalments of the loan it had approved in September, because Argentina was not fulfilling the targets of the loan agreement. Argentina by now had little chance of receiving loans from any foreign source.

Days after, from December 13 to December 20 a general strike occurred, accompanied with looting and protests which resulted in 24 deaths. Cavallo resigned on December 19 and

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[2] *"Corralito was the informal name for these measures taken in order to stop a bank run. The corralito almost completely froze bank accounts and forbade withdrawals from US dollar denominated accounts. The Spanish word corralito is the diminutive form of corral, which means animal pen, enclosure. The term alludes to the restrictions imposed by the measure."* (BG Group Plc. v. Argentine Republic. Final Award, 2007)

De La Rúa followed on December 20. *"On 1 December 2001, Decree 1570/01 imposed exchange controls and severe restrictions on the withdrawal of funds from the banking system (the corralito). Argentina subsequently declared a default on its foreign debt and IMF withheld funds scheduled to be delivered to Argentina by the end of that year. The IMF also publicly withdrew its support of Argentina's economic program."*(BG Group Plc. v. Argentine Republic. Final Award, 2007, p. 56)

The economic distress had turned into social turmoil, Argentina presented terrifying statistics: its stock index had lost more than 60% of its value during the last four years; more than 20% of Argentina's population was unemployed, households expending capacity was reduced in about 74% and the poverty level increased to 54.3% of the urban population of the country and the indigence level reached 24.7%. "*The political effects of this massive economic and social crisis, were "the political demonstrations, riots and looting in December 2001 which led to an abrupt end of De La Rúa's government" and the vacuum in the political power that followed his resignation."*(Continental Casualty Company v. Argentine Republic. Merits Final Award, 2008, p. 108)

### 2.5.The uprising of the faceless people

As Fernando Solanas describes in his documentary film 'Memorias del Saqueo', Argentina's history after the decline of the military dictatorship has been a succession of democratically elected leaders who betrayed the Argentinean people's will. It is described as a treason since all candidates promised productive revolution and different economic approaches, and in the end they all shamelessly transformed their program after a few days of government. As a result social movements in Argentina have great significance inasmuch as some of them struggled against the dictatorship of the 'Junta Militar' in the 1970's and 1980's. For instance, the mothers and relatives of the disappeared individuals during the dictatorship formed a group named ‘The mothers of the Plaza de Mayo”, that gathers in Buenos Aires’s symbolic square claiming information about their relatives and justice for the perpetrators.

Political scandals and economic unrest created a social movement known as ‘The spontaneous revolt of the faceless people’ (Solanas, 2004), composed by millions of Argentinean’s who filled the streets of the main cities of the country protesting on the situation and the manner in which the government managed affairs. The demonstrations formed in 2001 was massive as it included not only the politically sensible groups of society such as students, workers, teachers, women, commercial guilds, but all segments of the population as they were all affected by the on-going issues, especially with the *corralito*. *“By seizing its citizens' savings, the government has broken a basic contract, and violated the rule of law. Trust between government and citizens—the essential glue of a prosperous democracy—has been destroyed.”* (Argentina's Collapse: A Decline Without Parallel , 2002)

### 2.6. 2002: The after match

On January 1$^{st}$ 2002, Eduardo Duhalde takes office making harsh critics on Argentina’s free market system and all economic decisions taken before. Five days later, the Congress enacts various laws (within the Emergency law) which end with the currency board and plans to reduce the value of the peso on certain commercial transactions while implementing floating exchange rates on the rest of the operations. All contracts were converted into pesos, bank account controls were introduced, new taxes were created, and government debt was restructured.

Duhalde’s government devalued the peso to 1.40 per dollar, and later floated the exchange rate, allowing further depreciation. Forcibly converted dollar bank deposits and loans into pesos (“pesofication”) with an exchange rate of. (Deposits were converted at 1.40

pesos per dollar; loans, at 1 peso per dollar.) Interest rates were frozen at devaluation levels and amongst others, implemented the *corralón,* i.e. the unilateral prolongation of time deposits. (Joint Economic Committee Report for the United States Congress)

Moreover the Argentine government seized the dollar reserves of banks, costing them about $1.6 billion, imposed exchange controls (restrictions on buying foreign currencies), suspended bankruptcy proceedings and instituted double penalties for employers who lay off employees.

*"The Emergency Law abrogated the Convertibility Law so that the one-to-one peg of the Argentine peso to the United States dollar no longer existed. The Emergency Law provided for the switch into Argentine pesos of debts owed to the banking system, debts arising from management contracts governed by public law, and debts under private agreements. The law further provided for the renegotiation of private and public agreements to adapt them to the new exchange system."* (LG&E Energy Corp., LG&E Capital Corp.; LG&E International Corp. v. Argentine Republic. Decision on Liability, 2006, p.64)

The measures taken by Argentinean authorities not only affected its nationals, some of the measures taken when the crisis reached outrageous consequences had a vast impact on foreign investors, especially on their profits, expectations of gain and their assets. Besides *the corralito,* the end of the currency board by the Emergency Law 25.562 of 2002 affected the investor's expectations and the legal regime applicable in a sudden manner. Not only was the pegged currency eliminated but also all contracts that were denominated in dollars were converted into peso contracts. Bondholders were also affected harshly because Argentina defaulted, and had to restructure governmental debt.

During 2001 Argentina's economy shrank 5.5 per cent and a further 10.9 per cent in 2002. Bankruptcies reached record levels in 2002. A wave of defaults or liquidity problems at some of Argentina's largest companies began in March 2002, among the companies affected were the utilities *Metrogas*, *Telecom Argentina*, and *Aguas Argentinas*, plus Argentina's largest locally owned private-sector bank, Banco Galicia. Foreign banks and utility companies operating in Argentina experienced large losses related to the Duhalde government's economic policies. They included the U.S. banks Bank of America, Citigroup, FleetBoston Financial, and J. P. Morgan Chase & Co., as well as the utility companies AES Corporation, CMS Energy, Public Service Enterprise Group (PSEG), and Sempra Energy. (Joint Economic Committee Report for the United States Congress)

### 2.7. Final remarks

As described previously, the economic distress suffered by the Argentine Republic was not a matter that emerged overnight. It was the natural outcome of longstanding political regimes with unhealthy economic habits. It was originated by the "macroeconomic populism", whereas "*…weak elected governments alternated with military strongmen, both trying to buy popular support with populist programs they could not afford. In the effort to finance these programs, governments resorted either to borrowing from careless foreign bankers, with the end result being balance of payments crisis and default or to the printing press, with the end result being hyperinflation."* (Krugman, 2009, p. 30)

*"How was it possible that in so rich a country so many people were hungry? The country had been ransacked by a new form of aggression, committed in time of peace and in a democracy. It was a daily and silent violence that caused greater social disruption, more emigration and death than the terrorism of the dictatorship and the Falkland Islands war."* (Solanas, 2004)

The aftermath was devastating not only for Argentina's social tissue but for the State in the international realm. As mentioned previously, with the development of international investment law, investors are entitled to seek reparation for Argentina's politic and economic failure, unravelling massive claims under Bilateral Investment Treaties before international tribunals. *"Argentina's potential liability from these cases alone could be greater than U.S. $8 billion, more than the entire financial reserves of the Argentine government in 2002. Some have speculated that the total value of potential claims against Argentina could reach U.S. $80 billion."* (White, The Argentine Financial Crisis: State liability under BITs and the legitimacy of the ICSID system, 2002).

Having a more accurate picture of the events that prompted Argentina's economic distress, and having analysed the applicable law subject of this thesis, i.e. the state of necessity under customary international law, we will continue with an insight to the Argentinean cases adjudicated by international arbitral tribunals. Particularly:

i) The CMS Case

ii) LG&E

iii) The Enron Case

iv) The Sempra Case

v) BG

vi) Continental Casualty

# CHAPTER III LEGAL ANALYSIS OF ARGENTINA'S ILLUSTRATIVE INVESTOR – STATE DISPUTE CASES

The present chapter will explore the application of the concept and principles of necessity (as described in Chapter 1) by international investment tribunals to the situation of economic and financial distress in Argentina (as described in Chapter 2). As it was mentioned before, Bilateral Investment Treaties and investment chapters in Free Trade Agreements allow investors (non signing parties to the treaty) to take claims against the host State before international investment tribunals.

The International Centre for the Settlement of Investment Disputes (ICSID) is the most common mechanism used in the international investment area. ICSID is an autonomous institution established under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (Washington Convention). However, other facilities and arbitration rules, such as the NAFTA (for NAFTA parties) and UNCITRAL are used to solve investment disputes.

Arbitrators appointed to investment cases are usually highly regarded professors and international lawyers. The proliferation of international investment agreements has increased considerably the number of awards that have developed different topics regarding the scope of the agreement, the standards of protection and defences presented by States.

Since Argentina had signed various international investment agreements during the mandate of President Menem and also became a party to the Washington Convention, investors affected by the governmental measures took their claims to international investment tribunals. Since 2005, various awards have been rendered on the topic of state of necessity and the Argentinean crisis. A close study of such awards will reveal several problematic aspects with the consistency and legal approaches taken by arbitrators.

In order to understand the cases below, it is important to clarify that Argentina presented two defences against the claims of investors, article XI of the US-Argentina BIT and the customary international law defence of necessity. Thus, tribunals not only analyse the state of necessity under customary international law, but they also examine article XI of the US-Argentina BIT.

Article XI of the US-Argentina BIT, commonly known as a Non Precluded Measure, states the following:

*"[t]his Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfilment of its obligations with respect to the maintenance or the restoration of international peace or security, or the protection of its own essential security interests."* (Argentina - US BIT, 1994)Some tribunals decided that article XI enshrines the state of necessity defence developed by customary international law; while others determine that they are both different defences and pleas with separate effects. It is essential to look at both defences since certain tribunals make an inseparable analysis, and in others the examination of article XI contains aspects relevant for the customary defence.

### 3.1 <u>CMS Gas Transmission Company v. The Argentine Republic, ICISD Case No. ARB/01/8 (Award dated May 12th 2005)</u>

CMS is a company established under the laws of Michigan, United States. *Transportadora de Gas del Norte* (TGN) was one of the companies created for gas transportation when Gas del Estado was privatized and divided into various companies. CMS purchased 29.42% of TGN's shares. The claimant alleged that the government measures of 2002 led to a breach of the fair and equitable treatment standard, arbitrariness, discrimination, and the indirect expropriation of its investment.

Regarding the issue of necessity the Tribunal states that: *"The Tribunal, like the parties themselves, considers that Article 25 of the Articles on State Responsibility adequately reflect the state of customary international law on the question of necessity."* (CMS Gas Transmission Company v. Argentine Republic. Merits Final Award, 2005, p.315) Therefore, there is no doubt or questioning on the source of law alleged by Argentina and its effective recognition. This is unanimous in all investment tribunals dealing with the issue of necessity, not one of them questions their existence in the international law realm.

The Tribunal engaged in the quest of whether Argentina was protecting an essential interest. *"The need to prevent a major breakdown, with all its social and political implications, might have entailed an essential interest of the State in which case the operation of the state of necessity might have been triggered."* (CMS Gas Transmission Company v. Argentine Republic. Merits Final Award, 2005, p.319) When analysing if the essential interest was jeopardized by a grave an imminent peril, the Tribunal concluded that the situation justified the government's actions to prevent a worse situation, but that the relative effect of the crisis did not allow a finding in the terms of preclusion of wrongfulness.

Afterwards, the Tribunal examined whether the measures taken by the government were the 'only means' of safeguarding such essential interest. It recognized that definitively other policies were available for the authorities and consequently the requirement established in article 25 of the Articles on State Responsibility was not fulfilled. *"In CMS, the tribunal took for granted that alternatives existed; it simply held that since other measures were available, Argentina's measures were not the only way."* (Newcombe & Paradell, Law and Practice of Investment Treaties: standards of treatment, 2009, p. 518)

On the requirement which states that the breach of the obligation must not impair an essential interest of the State or of the international community as a whole, the award asserts that the essential interests of the other State are embodied in the Treaty, and will therefore be examined when studying the specific treaty defence. As for the second part of the requirement, the tribunal concludes that there is no impair of an essential interest of the community.

The tribunal recognized that in these economic policy scenarios, the State often has a role in the outcome of the different measures. *"In spite of the view of the parties claiming that all factors contributing to the crisis were either endogenous or exogenous, the Tribunal is again persuaded that similar to what is the case in most crisis of this kind the roots extend both ways and include a number of domestic as well as international dimensions. This is the unavoidable consequence of the operation of a global economy where domestic and international factors interact."* (CMS Gas Transmission Company v. Argentine Republic. Merits Final Award, 2005, p.328). The arbitrators then questioned on the substantial contribution of Argentina to the situation. They concluded that the situation of distress was not provoked by the decisions taken by a single administration; on the contrary they were the result of decades of policies. Therefore the State did contribute to the situation, excluding itself from the plea of necessity.

The tribunal treated the customary defence and the treaty defence in separate subchapters. However, it didn't distinguished the content and effect of each defence, and even mixed the analysis made when studying some of the requirements under customary international law in the treaty defence chapter. *"Arguably, the tribunal's approach was motivated by the party's pleadings, and in particular Argentina's failure to make submissions on the substantive content of Article XI, as distinct from the customary defence of necessity and in fact conflating the two issues."* (Newcombe & Paradell, Law and Practice of Investment Treaties: standards of treatment, 2009, p. 494)

In 2005, Argentina filed an application, requesting the annulment of the award due to manifest excess in powers of the tribunal and the fact that it failed to state the reasons on which it based its decisions. The Annulment Committee decided not to annul the award, arguing the inexistence of a ground for annulment, but criticized harshly the legal reasoning of arbitrators who drafted the award and decided the case.

One of the points in which the Committee disapprove of the outcome of the award was on the treatment of article XI of the treaty and the customary international law defence. *"The International Centre for Settlement of Investment Dispute (ICSID) ad hoc committee (Committee) in CMS took issue with the analysis in the CMS award. It regretted that the CMS tribunal had not been 'more explicit in specifying, for instance, that the very same reasons which disqualified Argentina from relying on the general law of necessity meant that the measures it took could not be considered "necessary" for the purpose of Article XI either.' But the Committee was even more critical of the merits of the tribunal's assimilation of the Article XI and necessity analyses."* (Newcombe & Paradell, Law and Practice of Investment Treaties: standards of treatment, 2009, p. 495)

The annulment proceedings decision states the clear difference between both exceptions presented by Argentina. The non-precluded measure contained in article XI is a provision which excludes certain State actions from the scope of protection of the treaty, rendering those acts as lawful and thus no breach of the treaty has been committed. On the other hand, as explained in Chapter 1, the state of necessity is a circumstance precluding the wrongfulness of an act, and therefore an effective breach was committed. *"The Committee's analysis highlights that the proper interpretive approach would have been first to consider whether the IIA breach was excluded by the express exception in Article XI. If the answer was negative, and if conduct was thus not in conformity with the treaty, only then should the tribunal have determined if responsibility could be precluded in whole or part under* *customary international law."* (Newcombe & Paradell, Law and Practice of Investment Treaties: standards of treatment, 2009, p. 496)

The tribunal agreed with Argentina finding that: *"Those two texts having a different operation and content, it was necessary for the Tribunal to take a position on their relationship and to decide whether they were both applicable in the present case. The Tribunal did not enter into such an analysis, simply assuming that Article XI and Article 25 are on the same footing."* (CMS Gas Transmission Company v. Argentine Republic. Annulment Proceeding, 2007, p.131)

Even though the Committee did not annul the award because it was circumscribed to the specific grounds for annulment, it expressed disapproval towards the legal reasoning of the arbitrators in the award. Various scholars such as Burke-White have established that the Committee had no obligation to expose the flaws contained in the award if none of them amounted for annulment. However, the Committee might have provided such conclusion in order to deprive the award of precedential weight. *"The September 25, 2007 decision of the Annulment Committee is a surprising and extraordinary piece of jurisprudence. The decision is so remarkable that it seems difficult to interpret it as anything but an attack on the ICSID system from within."* (White, The Argentine Financial Crisis: State liability under BITs and the legitimacy of the ICSID system, 2002, p. 27)

3.2 LG&E Energy Corp, LG&E Capital Corp. And LG&E International Inc. v. Argentine Republic, ICSID Case No. ARB/02/1(Award dated October 3rd 2006)

LG&E Energy Corp. and LG&E Capital Corp. are corporations created under the laws of Kentucky, United States while LG&E International Inc. is a corporation organized under the laws of Delaware, United States. LG&E collectively owns shares in three local gas distribution companies. Similarly as the CMS case, the claimant alleged breaches of the fair and equitable treatment standard, as well as arbitrariness and discrimination. LG&E also contends that the measures adopted were to be considered tantamount to indirect expropriation of its investment.

"*Under the emergency legislation, the Government permitted itself to either sign a renegotiated agreement or rescind the contract. During the renegotiation process, the Government did not offer to restore the legal guarantees that were eliminated by the emergency laws or to compensate LG&E for any losses incurred. Consequently, LG&E sought relief before an ICSID tribunal for Argentina's breaches of the US-Argentina BIT in the region of US $250 million plus interest and costs. Argentina invoked, inter alia, the state of necessity defence."* (Waibel & Kaushal, The Backlash against Investment Arbitration, 2010, p. 320)

On the issue of whether Argentina was protecting an essential interest, the tribunal had a sharp and decisive conclusion: *"Evidence has been put before the Tribunal that the conditions as of December 2001 constituted the highest degree of public disorder and threatened Argentina's essential security interests. This was not merely a period of "economic problems" or "business cycle fluctuation" as Claimants described (Claimants' Post-Hearing Brief, ¶ 14). Extremely severe crises in the economic, political and social sectors reached their apex and converged in December 2001, threatening total collapse of the Government and the Argentine State."* (LG&E Energy Corp., LG&E Capital Corp. And LG&E International Corp. v. Argentine Republic. Decision on Liability, 2006, p.231) Different from the analysis made in the CMS award, this tribunal did not considered the matter to be grey or full of shadows. For these arbitrators, an economic emergency constituted clearly a situation of grave danger for the State and its essential interests. *"To conclude that such a severe economic crisis could not constitute an essential security interest* *is to diminish the havoc that the economy can wreak on the lives of an entire population and the ability of the Government to lead. When a State's economic foundation is under siege, the severity of the problem can equal that of any military invasion."* (LG&E Energy Corp., LG&E Capital Corp. And LG&E International Corp. v. Argentine Republic. Decision on Liability, 2006, p.238)

The LG&E tribunal made primarily a study of article XI of the Argentina-US BIT in the light of the Argentinean crisis. Throughout the award it is possible to perceive some insight on the customary necessity defence even though in the end, the tribunal makes it clear that there is a difference between both exceptions, however it does not provide further explanation on which exactly is the difference. *"All of these devastating conditions – economic, political, social– in the aggregate triggered the protections afforded under Article XI of the Treaty to maintain order and control the civil unrest."* (LG&E Energy Corp., LG&E Capital Corp. And LG&E International Corp. v. Argentine Republic. Decision on Liability, 2006, p.237)

On the point of the level of State contribution to the emergency situation, the award asserts that: "*There is no serious evidence in the record that Argentina contributed to the crisis resulting in the state of necessity. In these circumstances, an economic recovery package was the only means to respond to the crisis. Although there may have been a number of ways to draft the economic recovery plan, the evidence before the Tribunal demonstrates that an across-the-board response was necessary, and the tariffs on public utilities had to be addressed. It cannot be said that any other State's rights were seriously impaired by the measures taken by Argentina during the crisis. Finally, as addressed above, Article XI of the Treaty exempts Argentina of responsibility for measures enacted during the state of necessity."* (LG&E Energy Corp., LG&E Capital Corp. And LG&E International Corp. v. Argentine Republic. Decision on Liability, 2006, p.257) In the same point it addressed the issue of ‘only means’ to protect the essential interest, and concluded that even though options are always available when deciding on governmental policies, a recovery plan in general was the only choice. Additionally it considered that no other State’s interests were impaired by the measures.

In consequence, the tribunal considered that Argentina was not to be held internationally liable for the measures taken in 2002 but only in a specific lapse of time. *“The tribunal excused Argentina from liability for breaches of the BIT under the Article XI defence during the specific period of December 1, 2001 to April 26, 2003. Outside of this time period, Argentina was still in breach of the BIT and would have to pay damages. This corresponds with the interpretation of a temporary fixed-window “excuse” necessity defence envisaged in Gabčikovo-Nagymaros.”* (Waibel & Kaushal, The Backlash against Investment Arbitration, 2010, p. 320)

In the end, the tribunal states clearly that article XI of the BIT and the customary international law concept of necessity, were two different defences. The arbitrators considered that the state of affairs triggered the application of article XI. *“While the Tribunal considers that the protections afforded by Article XI have been triggered in this case, and are sufficient to excuse Argentina’s liability, the Tribunal recognizes that satisfaction of the state of necessity standard as it exists in international law (reflected in Article 25 of the ILC’s Draft Articles on State Responsibility) supports the Tribunal’s conclusion.”*(LG&E Energy Corp., LG&E Capital Corp. And LG&E International Corp. v. Argentine Republic. Decision on Liability, 2006, p.245) The latter implies that an examination of the requirements of article 25 of the Articles on State Responsibility would purport the same outcome. However, it should be highlighted that the tribunal did not explained the difference between both defences and indicated that the application of either entailed the same analysis.

Later in the award, the arbitrators state the following: *"While this analysis concerning Article 25 of the Draft Articles on State Responsibility alone does not establish Argentina's defence, it supports the Tribunal's analysis with regard to the meaning of Article XI's requirement that the measures implemented by Argentina had to have been necessary either for the maintenance of public order or the protection of its own essential security interests."* (LG&E Energy Corp., LG&E Capital Corp. And LG&E International Corp. v. Argentine Republic. Decision on Liability, 2006, p.258) Although the Tribunal makes a clear reasoning regarding the reference to the ILC Articles, still remains unclear whether the Tribunal considers if such requirements of article 25 are to be fulfilled cumulatively or if it considers that under customary international law the result would have been different.

### 3.3 <u>Enron Corporation Ponderosa Assets v. Argentine Republic, ICSID Case No. ARB/01/3 (Award dated May 22nd 2007)</u>

Enron Corp. is a company incorporated under the laws of Oregon, which, together with its wholly owned subsidiary, Ponderosa Assets L.P (a company incorporated under the laws of Delaware) made an investment in the second gas transportation company in Argentina: *Transportadora de Gas del Sur* ("TGS"). The investment was made indirectly through the Consortium incorporated in Argentina: *Compañía de Inversiones de Energía S. A.* ("CIESA"), and represented a 35.5% participation in TGS capital stock.

As a result of the enactment of the Emergency Law (Law No. 25.561), the abolishment of PPI Adjustments on tariffs and the pesification of contracts, Enron claimed that Argentina had breached all the guarantees provided under the Argentina- US BIT. Specifically, that the measures taken by the host State constituted: (i) a wrongful expropriation both in the form of direct or indirect expropriation; (ii) a violation to the fair and equitable treatment and legitimate expectations; and (iii) full protection and security have not been provided to the investors.

The Respondent State contended that its measures have been precluded from wrongfulness pursuant to the state of necessity defence enshrined in Article 25 of the ILC Articles, as a consequence the State could not be upheld responsible. As mentioned previously, the tribunal recognized the applicable law invoked by Argentina and entered into the analysis of whether the requirements set forth in Article 25 were met.

First, the tribunal considered that the economic distress experienced by Argentina did not classify as an essential interest subject to the protection of the State under Article 25. "*The Tribunal has no doubt that there was a severe crisis and that in such context it was unlikely that business could have continued as usual. Yet, the argument that such a situation compromised the very existence of the State and its independence so as to qualify as involving an essential interest of the State is not convincing. Questions of public order and social unrest could be handled as in fact they were, just as questions of political stabilization were handled under the constitutional arrangements in force"* (Enron Creditors Recovery Corp. v. Argentine Republic. Merits Final Award, 2007, p. 96)

Furthermore, the arbitrators estimated that the scenario the State was facing was not grave and imminent. *"This issue is in turn connected with the existence of a grave and imminent peril that could threaten that essential interest. While the government had the duty to prevent the worsening of the situation and could not simply leave events to follow their own course, there is no convincing evidence that the events were out of control or had become unmanageable."* (Enron Creditors Recovery Corp. v. Argentine Republic. Merits Final Award., 2007, p. 96)

However, despite reaching these conclusions, the tribunal continued the examination of the requirements laid down in Article 25, to which it determined that they were not fulfilled based on the fact that the implemented measures were not the "only means" available to the Respondent State, among others.

"*A rather sad world comparative experience in the handling of economic crises, shows that there are always many approaches to address and correct such critical events, and it is difficult to justify that none of them were available in the Argentine case.*

*While one or other party would like the Tribunal to point out which alternative was recommendable, it is not the task of the Tribunal to substitute for the governmental determination of economic choices, only to determine whether the choice made was the only way available, and this does not appear to be the case*." (Enron Creditors Recovery Corp. v. Argentine Republic. Merits Final Award, 2007, p. 98)

Subsequently, in the analysis of requirement 1(b) of Article 25, the Tribunal confidently affirmed that the interest of others States was not impaired, but ruled that indeed Argentina contributed to the state of necessity, *ergo* breached condition 2(b) of Article 25. "*This is of course the expression of a general principle of law devised to prevent a party taking legal advantage of its own fault. Although each party claims that the factors precipitating the crisis were either endogenous or exogenous, the truth seems to be somewhere in between with both kind of factors having intervened, as in the end it has been so recognized by both the Government of Argentina and international organizations and foreign governments."* (Enron Creditors Recovery Corp. v. Argentine Republic. Merits Final Award., 2007, p. 99.)

As a result from all the above, the Tribunal stated that the requirements of the state of necessity defence were not fully met in the present case, thus the Respondent is responsible for the violations of the Argentina-US BIT provisions.

With regards to Article XI of the Treaty, the Tribunal reaches the conclusion that this article is *lex specialis* with respect to the circumstances precluding wrongfulness, however since the Treaty does not include any definition on what should be understood as essential security, the arbitrators must refer to customary international law contained in Article 25 of the ILC Articles. Therefore, as the treaty effectively imported the CIL necessity defence into the treaty, it concluded that the treaty did not preclude Argentina from raising such a defence. (Muchlinski, Ortino, & Schreuer, 2008, p. 489)

Nevertheless, since Argentina failed to meet the requirements demanded by CIL, it was obvious for the Tribunal that this defence will not prosper either.

Similarly as it happened in the CMS case, on February 21, 2008, Argentine filed a request for the annulment of the Award, claiming principally that the award failed to state the reasons on which it was based. Consequently, the Committee was constituted and they started the Annulment Proceeding.

Concerning the state of necessity defence, the Committee found certain inconsistencies relating the argumentation exposed by the Tribunal. Firstly, the Committee considers that the Tribunal relied only on an expert's opinion, for determining whether Argentina's actions were the only way to save the economy, and did not carry out a thorough analysis of the "only means" requirement. "*Even if, contrary to all appearance, the Tribunal did apply the "only way" requirement in Article 25(1)(a), the Committee considers that the Tribunal failed to state reasons for its decision. This constitutes aground for annulment under Article*

*52(1)(e) of the ICSID Convention."*(Enron Creditors Recovery Corp. v. Argentine Republic. Annulment Proceeding, 2010, p. 151)

Aftwerwards, the Committee clarified that the "only way" expression may have several interpretations:

There were genuinely no other measures that Argentina could possibly have adopted in order to address the economic crisis.

That there must be no alternative measures that the State might have taken for safeguarding the essential interest in question that did not involve a similar or graver breach of international law.

Thus, under the second interpretation the State could only invoke necessity if the action performed involved a less grave breach of international law. Moreover, the Tribunal failed to consider within the available measures the relative effectiveness of each measure and the fact of whom must evaluate which alternative is better. In other words, the Committee contemplates that there may be various alternatives; nevertheless in order to determined which one was the most adequate an assessment of its effectiveness must be done. By whom? The Committee does not provide a clear answer about it, but it suggests that it must be evaluated if the State when taking its decisions was aware of the relevant alternative.

*"In that event, the relevant question for the Tribunal might be whether it was reasonably open to the State, in the circumstances as they pertained at the relevant time, to form the opinion that no relevant alternative was open.*

*It is not for the Committee in these annulment proceedings to provide answers to these questions. It was however necessary for the Tribunal, either expressly or sub silentio, to decide or assume the answers in order to apply the "only way" provision of Article 25(1)(a)* *to the facts of this case."*(Enron Creditors Recovery Corp. v. Argentine Republic. Annulment Proceeding, 2010, p.152 -153)

Secondly, the next issue that the Committee finds consists that the Tribunal in no way explains why it concluded that Argentina had contributed to its state of necessity, but only relied in the economist opinion afforded by the Claimant State. *"The Committee finds that in reaching that conclusion, the Tribunal did not in fact apply Article 25(2)(b) of the ILC Articles (or more precisely, customary international law as reflected in that provision), but instead applied an expert opinion on an economic issue. 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" such as to preclude reliance on the principle of necessity under customary international law*."(Enron Creditors Recovery Corp. v. Argentine Republic. Annulment Proceeding, 2010, p.158)

For these reasons, the Committee finds that the decisions of the Tribunal that requirements of Article 25 of the ILC Articles were not met was tainted by annullable error. The Committee accordingly finds that the Tribunal's decision that Argentina is precluded from relying on the principle of necessity undercustomary international law must be annulled.

### 3.4 Sempra Energy International v. Argentine Republic, ICSID Case No. ARB/02/16 (Award dated September 28th 2007)

This dispute concerns the indirect investment of Sempra International ("Sempra") in two gas distribution companies, Camuzzi Gas Pampeana ("CGP") and Camuzzi Gas del Sur ("CGS"), which were privatized in 1992 by the Gas Law (Law 24.076). The investment was represented in 86.09% of CGP capital and 90% of the shares in CGS.

As in the Enron Case, the claimant contended that the measures from the Argentinean government prohibiting PPI adjustments of tariffs, the abolition of the calculation of tariffs in U.S. dollars, the unilateral modification of the gas Licenses without payment of compensation, and the failure to reimburse subsidies owed, breached the investor's rights enshrined in the Argentine-US BIT.

The particularity in this award relies in the fact that two of its arbitrators were part of the CMS Tribunal, and bearing in mind the LG&E award, this Tribunal decided not to set aside from what the CMS and Enron's Tribunals concluded regarding the necessity defence.

*"This Tribunal, however, is not anymore persuaded than the CMS and Enron tribunals about the crisis justifying the operation of emergency and necessity, although it also readily accepts that the changed economic conditions have an influence on the questions of valuation and compensation, as will be examined further below."* (Sempra Energy International v. Argentina Republic. Merits Final Award, 2007, p.103)

As a result, the findings made by the Tribunal were identical to the ones exposed in the Enron award; mainly that Argentina failed to fulfil the requirements of Article 25. For them, the economic crisis did not represent a grave and imminent peril and furthermore, the measures implemented were not "the only means" for the State to solve its essential interest. *"In spite of the parties' respective claims that the factors precipitating the crisis were either endogenous or exogenous, the truth seems to be somewhere in the middle, with both kinds of factors having intervened. This mix has in fact come to be generally recognized by experts, officials and international agencies."* (Sempra Energy International v. Argentina Republic. Merits Final Award, 2007)

Additionally, the determinations reached by this Tribunal with respect to the application of Article XI of the Treaty, the Tribunal considered that there was nothing that prevented an interpretation allowing for the inclusion of economic emergency in the context of Article XI. In other words the economic crisis could be framed on the defence provided by the BIT, which at the same time lead us to the state of necessity defence contemplated in Article 25.*“This Tribunal believes, however, that the Treaty provision is inseparable from the customary law standard insofar as the definition of necessity and the conditions for its operation are concerned, given that it is under customary law that such elements have been defined.”* (Sempra Energy International v. Argentina Republic. Merits Final Award, 2007, p.376)

Given this analysis and taking into account the fact that the State did not accomplished the exigencies of Article 25, the Tribunal determined the failure of Argentina’s necessity defence.

Next year, in 2008 Argentina filed a request for the annulment of this award, which succeeded in 2010 on the following grounds. The Committee concluded that the tribunal incurred in a manifest error of law by equating Article XI of the BIT with ILC Article 25, and assuming they were on the same footing, hence it failed to apply properly this provision of the BIT. *“On the basis of the above, the Committee considers that it is obvious from a simple reading of the reasons of the Tribunal that it did not identify or apply Article XI of the BIT as the applicable law, and that it failed to do so on the assumption that the language of this provision was somehow not legitimated by the dictates of customary international* law.” (Sempra International v. Argentine Republic. Annulment Proceeding, 2010, p.218)

### 3.5 BG Group Plc. v. The Republic of Argentina, UNCITRAL Arbitration Rules (Award dated December 24th 2007)

By the end of 2007, another award was rendered against Argentina. This case has procedural differences from the others studied in this chapter. First, this is the case of a

British investor, not American as in most of the other cases. Second, proceedings were not held under ICSID rules and facilities, instead an independent tribunal was established which followed UNCITRAL rules. However, this tribunal also examined the topic of necessity in the case of economic distress of Argentina.

BG Group is a company organized under the laws of the United Kingdom. BG purchased the 54.67% of the shareholding of Gas Argentino S.A., a consortium of investors who owned 70% of MetroGAS, a local gas distribution company. The claimant commenced proceedings seeking for compensation due to breaches of the United Kingdom – Argentina BIT, particularly of fair and equitable treatment, unreasonable measures and obligations under the umbrella clause.

Argentina invoked the state of necessity under customary international law as provided in article 25 of the Articles on State Responsibility. Additionally, it invoked article 4 of the UK – Argentina BIT which states the following: *"Investors of one Contracting Party whose investments in the territory of the other Contracting Party suffer losses owing to war or other armed conflict, revolution, a state of national emergency, revolt, insurrection or riot or resulting from arbitrary action by the authorities in the territory of the latter Contracting Party shall be accorded by the latter Contracting Party treatment, as regards restitution, indemnification, compensation or other settlement, no less favourable than that which the latter Contracting Party accords to its own investors or to investors of any third State. Resulting payments shall be freely transferable."* (Argentina - UK BIT , 1993). It is possible to observe that the wording of this article is not the same as article XI of the US-Argentina BIT.

Argentina established that even though the wording was not similar and there was no provision in the UK-Argentina BIT which assimilated to article XI of the US-Argentina BIT, such rule is considered to exist. *"Objecting to BG's comparison drawn on the basis of Article XI of the Argentina-U.S. BIT, which BG submitted was an "exculpatory expression" not contained in the Argentina-U.K. BIT, Argentina contended that the principle enshrined in Article XI of the Argentina-U.S. BIT exists regardless of its inclusion in the BIT. According to Argentina, a bilateral investment treaty cannot prevent a State party from adopting such measures as it deems necessary to maintain the public order and guarantee the protection of its own essential security interests."* (BG Group Plc. v. Argentine Republic. Final Award, 2007, p.373)

The tribunal concluded that article 4 of the applicable BIT was intended to grant national treatment and most favoured nation treatment to investors of the other contracting Party even in cases of emergency. *"Applying the interpretive principles of Article 31 of the Vienna Convention, this Tribunal concludes that Article 4 of the BIT does no more than ensure that the State does not treat the foreign investor less favourably than its own investor or investors of any third State with regard to "restitution, indemnification, compensation or other settlement" in case the foreign investor suffers losses due to, inter alia, a state of national emergency."* (BG Group Plc. v. Argentine Republic. Final Award, 2007, p.382) Since this BIT provision is similar to Article IV (3) of the US-Argentina BIT, Argentina used the same reasoning, before other tribunals, proving that the abovementioned provision, must not be interpreted as the state of necessity defence, now that it is only clause guaranteeing national treatment to the other state party investors, reasoning adopted by the arbitrators.

*"The Tribunal notes that the Argentina-U.K. BIT does not include a national security exception analogous to Article XI of the Argentina-U.S. BIT."* (BG Group Plc. v. Argentine Republic. Final Award, 2007, p.385) Therefore, the analysis of the BG Group is not mixed with a study of a treaty-based provision as in the other cases.

The tribunals begins the study of the defence under customary international law by considering that article 25 of the Articles on State Responsibility may not apply in the case of international responsibility of a State when breaching provisions contained in a bilateral investment treaty. *"Article 25 may relate exclusively to international obligations between sovereign States. From this perspective, Article 25 would be of little assistance to Argentina as it would not disentitle BG, a private investor, from the right to compensation under the Argentina-U.K. BIT."* (BG Group Plc. v. Argentine Republic. Final Award, 2007, p.408)

The tribunal recognizes that one of the situations that exclude the plea of necessity by a State is when a source of international law or a peremptory norm excludes the possibility of alleging necessity. In this vein, the award established that it could be argued that the treaty implies such exclusion. If this were the case, Argentina would not be able to present the necessity defence. Nevertheless, it should be noted that the award does not give details on why the treaty excludes the possibility of necessity. This exclusion is not clear in the text of the treaty.

Finally, the award concludes the analysis of necessity by stating that the result of applying or not article 25 does not make a difference on the topic of compensation. *"Accordingly, whether the Tribunal accepts or rejects the application of Article 25 of the ILC Draft Articles, the result is the same: Argentina may not invoke the "state of necessity" doctrine under customary international law to excuse liability for breach of Article 2.2 of the Argentina-U.K.BIT, or its obligation to pay compensation under the treaty."* (BG Group Plc. v. Argentine Republic. Final Award, 2007, p.412)

### 3.6 Continental Casualty Company v. Argentine Republic, ICSID Case No. ARB/03/9 (Award dated September 5th 2008)

Continental Casualty is a company organized under the laws of Illinois, United States. In 2000, the company invested in Omega ART (later CNA ART), the privatized sector of worker's insurance. According to the claimant, Argentina breached the bilateral investment treaty, particularly the following provisions: free transfer of funds, fair and equitable treatment, indirect expropriation and the obligations under the umbrella clause.

In this case, the Tribunal made a distinction from the beginning between the defence contained in article XI of the BIT and the customary international law defence of necessity. *"It noted that Article XI is a safeguard clause that recognizes "reserved rights" or that contemplates "non-precluded" measures to which a contracting state party can resort. Measures taken in accordance with Article XI lie outside the scope of the BIT and are not in breach of the relevant BIT provision. On the other hand, the necessity defence (as stated under ILC Article 25) precludes the wrongfulness of an act that breaches an international obligation. The two provisions thus regulate different situations."* (Waibel & Kaushal, The Backlash against Investment Arbitration, 2010, p. 321) The award establishes the different characteristics and effects of both exceptions.

Once the award explains such difference, the Tribunal states that the analysis will firstly focus on article XI of the BIT to conclude whether the actions taken by Argentina lie outside the scope of protection of the treaty and therefore no breach has been committed. *"The Tribunal will therefore focus on the analysis of Art. XI and the conditions of its application, referring to the customary rule on State of Necessity (as enshrined in Art. 25 of the ILC test) only insofar as the concept there used assist in the interpretation of Art. XI* *itself."* (Continental Casualty Company v. Argentine Republic. Merits Final Award, 2008, p.168)

Afterwards, when the tribunal realized there were no particular interpretations of the requirements contained in article XI, it decided to analyse the case in the light of Trade Law. *"However, the tribunal stated that its reasoning could not be based on the requirements of the necessity defence as understood under customary international law and found it more appropriate to rely on the case law of General Agreement on Tariffs and Trade (GATT) and World Trade Organization (WTO) panels."* (Waibel & Kaushal, The Backlash against Investment Arbitration, 2010, p. 322)The application of the necessity defence in international trade law has not been applied previously, by any investment tribunal.

The Tribunal asserted that the wording of article XI of the treaty was similar to the wording of clauses contained in Friendship, Commerce and Navigation treaties signed previously by the United States. Subsequently, FCN treaties reflected the wording of GATT and other trade agreements. *"Since the text of Art. XI derives from the parallel model clause of the U.S. FCN treaties and these treaties in turn reflect the formulation of Art. XX of GATT 1947,291 the Tribunal finds it more appropriate to refer to the GATT and WTO case law which has extensively dealt with the concept and requirements of necessity in the context of economic measures derogating to the obligations contained in GATT, rather than to refer to the requirement of necessity under customary international law."* (Continental Casualty Company v. Argentine Republic. Merits Final Award, 2008, p.192)

Therefore the Tribunal examined the application of article XI of the BIT in the Argentinean economic crisis, in the light of WTO decisions adopted by panels in the context of trade between States. The reasoning explained by the Tribunal to invoke WTO standards for the necessity defence is weak, WTO rules were designed to regulate aspects related to commercial agreements between States, and should not be applied to scenarios which differ substantially. Doctrine (Álvarez & Brink, 2010) has harshly criticized this reasoning, and regularly investment tribunals do not apply WTO standards to investment cases. Nevertheless, even in this remote scenario, certain aspects of necessity in customary international law were implicitly treated.

On determining whether an economic emergency could jeopardize an essential interest of the State, the following was concluded: "A severe economic crisis may thus qualify under Art. XI as affecting an essential security interest in the broad sense, as described by the Tribunal above. The Tribunal is comforted in this approach by previous ICSID awards in other arbitrations brought against Argentina (although perhaps their discussion of the issue does not as clearly distinguish between the requirements of Art. XI and Art. 25 of the ILC text)." (Continental Casualty Company v. Argentine Republic. Merits Final Award, 2008, p.178)

Then the Tribunal engaged in the question of whether Argentina had other means available to soothe the economic and social distress. It is important to remember that in trade law the other means must be 'reasonable' available, such wording is not present in article 25 of the Articles on State Responsibility nor in article XI of the BIT. "*…the Tribunal is mindful that it is not its mandate to pass judgment upon Argentina's economic policy during 2001-2002, nor to censure Argentina's sovereign choices as an independent state. Our task is more modestly to evaluate only if the plea of necessity by Argentina is well-founded, in that Argentina had no other reasonable choice available, in order to protect its essential interests at the time, than to adopt these Measures."* (Continental Casualty Company v. Argentine Republic. Merits Final Award, 2008, p.199)

The claimant asserted that negotiations were possible between different Argentinean authorities and multilateral organizations. On this point, the Tribunal responded: *"The evidence does not permit the Tribunal to conclude that "further negotiations between federal authorities and the Provinces and the multilateral institutions" could have formed the basis for Argentina obtaining additional external support."* (Continental Casualty Company v. Argentine Republic. Merits Final Award, 2008, p.204)

Another highlight of this award is that, unlike the others, it goes measure-by-measure determining with more accuracy whether the policy adopted was inevitable and necessary. For instance regarding the block of bank accounts it stated: *"The block was adequate and effective in respect of its legitimate aims to prevent further fall in bank deposits that would have brought about the banks' bankruptcy, as well as the exhaustion of the country's reserves."* (Continental Casualty Company v. Argentine Republic. Merits Final Award, 2008, p.265)

It also made assertions on the devaluation of the currency: *"For the purpose of the present legal evaluation, devaluation has thus to be considered inevitable in view of the economic unsustainability of the parity with the U.S. dollar, and because of the run on deposits and the flight from the peso which had made the Corralito necessary."* (Continental Casualty Company v. Argentine Republic. Merits Final Award, 2008, p.210) Similar conclusions were made on the pesification of contractual obligations and tariffs.

Additionally, for the first time a tribunal addressed the role of the International Monetary Fund in the adoption of policies in the decade of 1990 and later in 2002. *"Thus the IMF had continued supporting Argentina all along. It is also a fact that the IMF had recognized the negative impact of various exogenous factors in this failure."* (Continental Casualty Company v. Argentine Republic. Merits Final Award, 2008, p.214)

The Tribunal concluded that the determination of whether Argentina had contributed to the situation of crisis or not was more complex than just establishing that the government made several decisions that definitively affected the scenario. It asserted that in economic policies contribution is always obvious and that such decisions taken on economic aspects were regarded as positive years before even demonstrating growth and low inflation.

*"It cannot be denied that a country is always ultimately responsible of its economic policy and of its consequences, at least politically and economically. The conduct of economic affairs, as any other affairs, pertains to the Government, so that the state bears the ultimate responsibility for any failure…Our analysis in the preceding paragraphs shows that the economic and exchange policies whose ultimate unsustainability led to the crisis were regarded as sound economic policies which had been beneficial for years to Argentina's economy. The fixed parity/convertibility/currency board system was praised by the international financial community and by many qualified observers. It had been recommended by the IMF and received its massive financial assistance, as well as the political support of the United States."* (Continental Casualty Company v. Argentine Republic. Merits Final Award, 2008, p.235)

## CHAPTER IV ECONOMIC DISTRESS AND STATE OF NECESSITY

After a general presentation of the necessity defence under customary international law, an explanation of the basis and history of Argentina's economic and social disaster of 2001 and a summary of the manner in which investment tribunals have applied the defence when analyzing the Argentinean case, it is now the moment to gather conclusions on the topic and set forth questions not yet resolved.

In order to establish whether or not a situation of economic distress can be accurately analysed under the rules of customary international law concerning necessity, it is important to go through each of the requirements set forth in article 25 and see the current status of the analysis done by investment tribunals on each point, i.e:

1. Essential interest of invoking State;
2. Grave and imminent peril;
3. "Only Means";
4. Impairment of essential interests of other states or international community;
5. International obligation in question does not preclude the use of defence;
6. State has not contributed to the situation of necessity;
7. Ius cogens.

Additionally, there are aspects worth considering outside the scope of article 25 of the ILC Articles that affect in a positive or negative manner the development of necessity in the investment regime.

Since the ruling of Gabcikovo-Nagymaros by International Court of Justice, it is well known and recognized by arbitrators that the requirements contained in Article 25 must be cumulatively fulfilled in order for the necessity plea to succeed. This threshold has its foundation on the exceptional character this defence possesses. In the cases at hand, some tribunals have found that Argentina failed to comply with the requirements of this defence, even though some of them were solidly proved.

First, it is important to meditate, before determining if the situation of economic emergency constitutes a grave and imminent peril, about the essential interest to be protected by the State. This matter has been addressed and analysed by most judges and tribunals, however a detailed analysis of what we must understand by essential interest under an economic scope must be done.

Although no venue, or the International Law Commission have established a definition on what should be understood as essential interest, albeit some guidelines have been established. For instance, it has been understood that it implies not only circumstances threating the very existence of the State, but also grounds of public interest or of the economic necessity of the State. (Muchlinski, Ortino, & Schreuer, 2008, p. 468)In Argentina's scenario, which is the essential interest of the State? Is it its social order? Or perhaps: the State's economic wellbeing?

In the Enron and Sempra cases, both Tribunals considered that the economic circumstances lived by Argentina were not different from a typical crisis suffered by any other State, but did not defined on essential interest. Meanwhile, the CMS Tribunal described it as the need to prevent a major breakdown, with its social and political implications. The LG&E tribunal on the other hand, considered that the severe crisis threatened the total collapse of the government and the Argentinean State. Additionally it asserted: *"To conclude that such a severe economic crisis could not constitute an essential security interest is to diminish the havoc that the economy can wreak on the lives of an entire population and the ability of the Government to lead. When a State's economic foundation is under siege, the* *severity of the problem can equal that of any military invasion."* (LG&E Energy Corp., LG&E Capital Corp. And LG&E International Corp. v. Argentine Republic. Decision on Liability, 2006, p.238)

No tribunal has yet determined, under article 25, which is the essential interest of the State that is to be protected in cases of severe economic crisis. Perhaps the clear identification of such interest would result in a more accurate analysis of necessity in economic scenarios. As mentioned above, on one hand the essential interest was linked with the social and political inestability, whereas on the other Tribunals associated it exclusively with macroeconomic statistics.

Now, examinining the second characteristic of this defence, the essential interest of the State should be threatened by a grave and imminent peril in order for necessity to preclude wrongfulness of an act.*"To date, IIA tribunals have consistently held that an economic crisis can, in principle, threaten a state's 'essential interest.'"* (Newcombe & Paradell, Law and Practice of Investment Treaties: standards of treatment, 2009, p. 517)As the International Investment Agreements Tribunals point out, the economy does not represent the peril itself, but rather its recession or depression manifested social and political crisis that was perceived in Argentina by the end of 2001.

As stated, the peril should have the characteristics of grave and imminent. The case of Argentina, as explained in Chapter II, was the product of decades of different policies and decisions that exploded in a sequence of events in 2001. Looting, anguish, riots, political instability and the economic statistics were all elements of a disastrous picture that became quite evident by 2001. However, when dealing with economic recessions in general terms, sometimes the gravity and proximity of the peril are difficult to perceive. The effect of decisions taken over macroeconomic variables cannot be grasped overnight.

Does the situation have to reach unmanageable conditions in order for it to be considered grave and imminent? Which should be the standard for grave economic situation?, A devaluated currency?; An extremely low GDP? A high rate of unemployment? Or should we wait for starvation, riots and deaths from households in order to fulfil this requirement? CMS, Enron and Sempra tribunals determined that the crisis did not meet the threshold of grave and imminent. Some of them stated that total economic and social collapse was required in order for the plea to be available in scenarios of economic crisis. However it is important to remember the consequences that the *corralito* entailed. *"By seizing its citizens' savings, the government has broken a basic contract, and violated the rule of law. Trust between government and citizens—the essential glue of a prosperous democracy—has been destroyed."* (Argentina's Collapse: A Decline Without Parallel , 2002)

Following with the third positive formulation, i.e. "the only means" requirement Arbitral tribunals all struggled when determining whether the economic recovery plan executed by Argentina since 2002 was the only means to safeguard the State's essential interest. At first sight this requirement becomes difficult when examining a situation of economic distress. When governments take different decisions that affect macroeconomic factors, they usually have a variety of options from which to select the measure they consider most appropriate. It is quite rare to find a situation in which economic distress can be soothed by "only means".

Another relevant question is whether tribunals should establish or identify which are the other available means that a government had when it decided to breach the obligations set forth in an international treaty. This requirement is analysed thoroughly in Enron's Annulment Decision, where the Committee censured the fact that the Tribunal relied its decision on the opinion of an expert in the field of economics and finance. Precisely, it recognized that a State before a macroeconomic dichotomy would always have other means; therefore it will never fulfil the requisites of this defence. That is why it asserted that Tribunals must analyse if the States whenever taking the macroeconomic decisions are aware of the existences of the other effective means *"The CMS, Enron and Sempra Tribunals all fail to suggest alternative courses of action Argentina could have followed or to consider the counterfactual argument of the results such alternative policies might have entailed for both the state and investors."* (White, The Argentine Financial Crisis: State liability under BITs and the legitimacy of the ICSID system, 2002, p. 20)

The Continental Casualty Tribunal carried out an even more detailed analysis than Enron and Sempra on this matter. As mentioned before, the award examines each of the measures taken by the government that affected the investors and determines whether or not there were other means of reaching the same outcome. For instance, in the pesification of contractual obligations and tariffs it stated: *"The Tribunal finds that de-dollarization was inevitable in the situation facing Argentina, in order to achieve a balanced distribution of the burden of the devaluation and of the abandonment of the convertibility at par with the dollar, once the fiction that pesos and dollars were equivalent had been discredited by the massive flight from peso to dollar (which had become a cause for the unsustainability of the very convertibility at par)."* (Continental Casualty Company v. Argentine Republic. Merits Final Award, 2008, p.214)

To support this approach, scholars have presented the idea of analyzing this requirement in the light of additional criteria in order for economic situations to be easily examined. *"It has been argued that the better approach would be to assess whether the specific measures in question were the 'only way' to respond to the crisis in light of their potential effectiveness and proportionality in responding to the threat."* (Newcombe &

Paradell, Law and Practice of Investment Treaties: standards of treatment, 2009, p. 519) Economic measures can be qualified in their effectiveness and proportionality. *"The key question facing the four Tribunals in this regard was how to interpret the no other available means requirement. Would it be sufficient to invalidate the plea of necessity if, for example, there were some other policy choice open to Argentina or would it have to be shown that there was an equally effective policy response open to Argentina that would not have breached the substantive protections of the BIT?"* (White, The Argentine Financial Crisis: State liability under BITs and the legitimacy of the ICSID system, 2002, p. 19)

Dealing with the last positive formulation in Article 25 in which is required that the breach of the international obligation does not impair the interest of other State or the international community, some comments must be made.

First, it is clear that this requirement obeys to the classic formulation of State responsibility among States for internationally wrongful acts. The investment regime does not take into account different interests, besides the ones of the signatory parties and its investors. In the present treaty, although it is concluded and ratified between States, the interests at stake are the ones belonging to the investor and the host State, thus it seems difficult to determine to what interests we must refer to in order to examine the non-impairment.

At first sight it may seem disproportionate to compare the State's interest with the investor's interest, inasmuch as it is clear that in all legislations the general interest prevails over the individual one. However, where do we leave the object and purpose of Bilateral Investment Treaties?

Scholars suggest that the essential interest that must not be impaired is the one pertaining to another State, after all, BITs seek to protect in the best possible way the rights and expectations of foreign investors, but that does not mean that such rights are imperative and absolute. *"In any case, some consideration could be given to the fact that since necessity is without prejudice to the question of compensation, application of necessity does not necessarily entail complete abandonment of some measure of investment protection, hence the object and purpose of IIAs is not defeated."* (Newcombe & Paradell, Law and Practice of Investment Treaties: standards of treatment, 2009, p. 520)

Moreover, although all six cases, do not explain how Article 25(1)(b) should apply in the case of IIAs, they all agreed on the fact that no third party interest had been violated under the Argentine-US BIT, by the measures taken.

Turning to the negative formulations established in Article 25, it is important to notice that none of the Tribunals dealt with the exception related to the exclusion of the necessity plea by a source of law or a peremptory norm. In relation with the latter, it has remained clear that no *jus cogens* norm can be violated, and if it is so, there is no way of precluding the wrongfulness from this act. This can be evidenced in the fact that a sole article (Article 26) has been drafted for this purpose.

Besides, the BG Tribunal that suggested the possibility of invoking a provision from the UK-Argentina BIT without further considerations on this matter, there was no discussion over this requirement since the Argentina- US BIT does not exclude the possibility of the plea of necessity.

Finally, dealing with perhaps the most troubled exception that must be accomplished by the States alleging necessity, is the non-contribution from the State towards the situation of necessity. The reasoning behind this requirement is evident when the scenario involves for instance, cases of use of force; however in economic situations the circumstances are totally different.

Economic policies are always the outcome of State decisions, and therefore non-contribution to this situation becomes impossible. There may be cases in which the global economic scenario may influence the situation on national markets, for example, as recalled in Chapter II, the repercussion of the Tequila crisis in 1995 on Argentina's economy. Nevertheless, the direction of a country's economy has always relied on its national authorities and therefore its performance will always be responsibility, in Argentina's case, of its president. *"A tragicomic spectacle of a succession of five presidents taking office over a mere ten days" followed*" (White, The Argentine Financial Crisis: State liability under BITs and the legitimacy of the ICSID system, 2002, p. 5).

The tribunals, such as *Enron* and *Sempra*, concluded that there was a substantial contribution by Argentina, even though both endogenous and exogenous factors generated the crisis. On the contrary, the *LG&E* tribunal decided the matter proposing a reversal in the burden of proof, and stating that there was no serious evidence that Argentina contributed to the crisis. *"The approach taken by the majority of the tribunals thus far is, again, problematic because the analysis used by these three Tribunals essentially renders the necessity defence a legal nullity as a state will, almost without exception, have contributed at least in some indirect way to whatever emergency it may face and such a state will also, in almost every circumstance, have more than one possible policy response to such a situation."* (White, The Argentine Financial Crisis: State liability under BITs and the legitimacy of the ICSID system, 2002, p. 22)

The amount of cases that have analyzed Argentina's scenario of economic distress under the customary necessity defence, from which the most relevant were selected to be explored in Chapter III, seem to be enough for the creation of an unambiguous position towards the various requirements set forth in article 25 of the ILC Articles. Certainly, the topic should be already settled or at least more clearly developed for future cases in which the same issue will be examined.

The poor development of the necessity defence in the investment arbitration regime can be partly attributed to the confusion created by article XI of the US – Argentina BIT in most of the cases. The analysis of article XI pollutes the exam of the necessity defence of article 25, and therefore there are no clear answers notwithstanding the amount of cases. Most tribunals failed to identify the difference between both defences. Some of them decided that article XI of the BIT enshrines the customary international law defence, and therefore applied the same analysis to both exceptions. *"In CMS, Enron and Sempra, IIA tribunals applied the test of necessity in customary international law to the essential security clause of Article XI, Argentina-US (1991)."* (Newcombe & Paradell, Law and Practice of Investment Treaties: standards of treatment, 2009, p. 494) Others determined that, even though they were two different defences, since the treaty does not provide criteria for the interpretation of article XI, the criteria for the interpretation of article 25 should be considered. In the end, the requirements contained in article 25 were treated and judged but to interpret a treaty provision, not the customary defence.

Article XI contains non-precluded measures, that is, the conduct of a State that does not fall within the scope of protection of the treaty because of special circumstances, and thus no breach of an international legal obligation has been committed. On the other hand, necessity is a circumstance precluding wrongfulness. *"As the Draft Articles explain, the defence of necessity is a secondary rule of customary international law that governs "the circumstances in which the wrongfulness of conduct under international law may be precluded*." (White, The Argentine Financial Crisis: State liability under BITs and the legitimacy of the ICSID system, 2002, p. 9)

The Continental Casualty tribunal began the analysis distinguishing between both defences and the different effects they generated. It was meant to be the first investment arbitration that understood such difference and having that as base, more appropriate conclusions could have been reached. Nevertheless, when discovering that no criteria existed for the interpretation of the treaty-based provision, it decided to examine the article in the light of trade law doctrine and previous WTO panel decisions. The decision only develops the doctrine of necessity in customary international law inasmuch as certain requirements are similar to the ones established for the necessity plea in the self-contained regime of trade law.

It is essential to underline that the Argentinean cases are the first scenarios in which arbitrators have engaged in the examination of clauses such as the one contained in article XI. *"Despite the fact that NPM clauses are, in fact, relatively widespread in BIT agreements and occur in most, if not all, BITs of the U.S., Germany, India, Canada and the Belgian-Luxembourg Union, the Argentine cases present the first test of such cases in investor-state arbitration."* (White, The Argentine Financial Crisis: State liability under BITs and the legitimacy of the ICSID system, 2002, p. 8)

The cases presented in Chapter III are also the litmus test of the necessity defence to preclude the wrongfulness of acts committed during economic crisis, not only in the investment regime, but also in the current globalized state of affairs. *"Argentina's plea of necessity under customary law represents the first modern necessity claim in investor-state arbitration. While the International Court of Justice recognized the validity of the necessity defence in the Gabcikovo-Nagymaros Projects Case, the Court found the defence inapplicable in the case as Hungary was deemed to have other means available to address the environmental threats to its essential interests."* (White, The Argentine Financial Crisis: State liability under BITs and the legitimacy of the ICSID system, 2002, p. 10) The fact that Gabcikovo-Nagymaros is the most detailed ICJ decision on the requirements established by the ILC for a necessity plea reflects that judicial and arbitral decisions outside of the investment realm have not yet developed sufficient criteria to nourish the investment system.

Finally, it is necessary to address the fact that irregularities and a lack of detailed and rigorous investigations and examinations by tribunals have shaped this dark topic on which much has been said but too little has been clearly concluded. Precedent is not a characteristic of the investment arbitration regime, nevertheless doctrines are created and decisions taken eventually nourish other tribunal's reasoning. Therefore it is possible to assert that inconsistency is a symptom of malaise within the system. *"The decisions reached by investment treaty tribunals have thus been strikingly inconsistent, even where tribunals shared an arbitrator."* (Waibel & Kaushal, The Backlash against Investment Arbitration, 2010, p. 326)

Several of the mentioned tribunals even had the same arbitrator, who had voted differently in the other cases. For instance, Judge Francisco Rezek sat on the panel of LG&E and CMS, whereas Professor Albert Jan van den Berg was member of the Enron and LG&E tribunal. The decisions in these cases were unanimous. *"The CMS and Enron tribunals came to the same conclusions but the conclusions of the LG&E tribunal differed despite the fact that it was faced with similar facts arising out of the same government measure and was called to interpret the same treaty provisions in the BIT between the US and Argentina."* (OECD, 2007, p. 102) Not only did the cases have in common some arbitrators, but they all examined the same factual background, in the light of the same treaty.

## CONCLUSIONS

Considering the number of academic papers, debates and publications made on the topic analysed, the necessity defence in investment law may seem as a poured subject where everything has been said. The fact that various tribunals have assessed this circumstance precluding wrongfulness under the same facts and in the light of the same treaty provisions, would lead to a reasonable expectation of a consistent jurisprudence. On the contrary, the confluence of different awards and opinions on this matter reflect the existent gap in international investment law where no consensus has been reached.

Thus, after a thorough investigation on the matter, various things can be noted before examining the central question of this thesis.

First, taking into consideration, the number of BIT's concluded among States in the last years, the investment protection regime with all its particular topics becomes of paramount importance not only to foreign investors but also to States. *"The number of investment treaties-both bilateral (BITs) and multilateral (MITs) - has skyrocketed since the late 1980's, increasing from 385 in 1990 to 2,495 in the late 2005*." (Muchlinski, Ortino, & Schreuer, 2008, p. 461) Experience demonstrates that if the number of international obligations acquired by States increases, the number of disputes and arbitrations increases as well. The probability of investment tribunals analysing again the topic of necessity in situations of economic distress not only increases with the number of BITs signed but also with the globalization of economic relations which multiplies the effect of economic and financial outbursts around the planet.

If we make a further analysis of why the Argentinean State should not be held responsible for the violation of the BIT's provisions, it is not due to the effects caused by a successful necessity defence, but rather for the inconsistencies of various awards in which arbitrators failed to explain their reasons in determining the applicable law and the content of the ILC requirements when applicable. This can be evidenced in the annulment decisions in which the Committees detected flaws in the argumentation sustained by the Tribunals, albeit none of the Committees provided an answer of which was the correct assessment that must be followed by the arbitrators and hence, leaving the issues at hand, unsolved.

Precisely, one of our major conclusions is that the elaboration of a necessity defence under economic distress has not been extensively examined yet in international public law. There have been approaches based on what has been construed in the law of State responsibility *vis a vis* another State, and in the process of dealing with the particularities of the investment regime and the economic scenario, the tribunals faced the difficulties in the application of its requirements. As a consequence, Argentina failed to preclude its wrongfulness under such standards.

Afterwards, the annulment committees highlighted the errors incurred by the Tribunals, mainly due to their lack of a deep judgement over the requirements of Article 25 without providing a key answer if whether those requirements were applicable or whether Argentina fulfilled or not such demands. This might be attributed on the fact that the annulment mechanism has not been developed enough to afford a clear answer regarding this defence.

What can be concluded, for a fact, is that the difficulties discovered in the Annulment Committees' analysis and the distinct rulings by the tribunal awards raise various questions. Among others the central question of this thesis: **Can Economic Distress Be Analysed Under The Rules Of Customary International Law?**

We must clarify that the purpose of this thesis was not to provide an answer on how should the tribunals must have adjudicated the abovementioned disputes, neither a formulation of a new defence. But, instead, a critical insight of the state of necessity under the investment law regime, taking as case studies the Argentinean cases.

In this vein, we must conclude in first place, that it is widely accepted and acknowledged, not only by the arbitrators of the Argentinean cases but by the international community, that the work contained in Article 25 of the ILC Articles represents customary international law.

In second place, leaving aside the discussion whether Article XI precludes the possibility of making use of this defence, as elucidated in Chapter IV, and considering that if we associate economic peril with the social and political disturbances it may entail, economic stability therefore can be considered an essential interest of the State worth protecting.

In third place, we believe that customary international law, as the beacon to be followed when examining this defence, can be applied to investment disputes originated around an economic crisis. However, we believe that the requirements laid down by the ILC and supported further by judicial cases, must be applied with certain adaptability[3] to the circumstances, since we are not analysing the act of a State against another State, but rather an internal act of the State in the exercise of its sovereignty, that has the obligation to respect the expectations of its foreign investors. For instance, the exception whereas the State must not have contributed to the State to its *status quo* exception must be assessed with a different scope, and not with the severity employed by State-to-State venues.

Although neither the methodology nor the approach when assessing the requirements is clear enough, this defence has solid grounds, which reflect the understanding of the international community of the characteristics that an exceptional defence may need to

[3] For instance, the relativity and effectiveness of governmental measures must be examined whenever making a decision of macroeconomic character.

accomplish in order to achieve the preclusion of wrongfulness of an international act, therefore this work must not be disposed but rather improved. Even more, when the probability of economic distress may threaten the interests of the States and its citizens is considerable high, e.g.: the economic crisis faced nowadays by Greece, Spain and Italy.

The most critical requirements contained in article 25 when analysing economic distress scenarios are: i) The requirement for the measure taken to be the "only means" of safeguarding an essential interest and ii) The negative formulation which asserts that the State cannot contribute to the situation. As explained in Chapter IV of this thesis, both of these formulations are almost impossible to be fulfilled in the economic crisis scenario since in macroeconomic choices there is always a variety of possible policies to adopt. Additionally economic decisions are always State policies and thus imply the State contribution.

Nevertheless, we believe this obstacle should not exclude the application of article 25 to investment disputes which concern economic distress. The fact that the investment regime nourishes from the international public law realm cannot be modified since the legal instruments are created and endorsed between States. There is no clear path to follow on this matter, but the agents involved in the investment area have the possibility of fulfilling this gap with a number of future actions. Perhaps the possibility of including a special clause in Bilateral Investment Treaties , including an express reference to article 25 of the ILC Articles and modifying certain requirements in order to invoke economic distress without encountering the mentioned obstacles. Furthermore, investment tribunals have the opportunity to create new lines of thought and analysis of this topic, hence generating solid jurisprudence to reference other tribunals.

As mentioned earlier, lots remains to be said on the topic and the system will soon require clear conclusions. In the end the analysis of the necessity defence turns out to be essential for the philosophy and spirit of the entire investment system. Topics such as the particular claimants, who have standing before tribunals, the nature and extent of the standards to which States oblige, and the clear establishment of possible defences to be raised by States, are all fundamental matters which sustain a solid international legal regime. *"After all, BITs represent an explicit bargain between the benefits of increased investment flows that follow from legalized investor protections and the need for states to preserve policy flexibility in ways that could impair investor interests. If ICSID Tribunals fail to recognize or accept the nature of that bargain underlying many BITs, states may be far less willing to accept direct investor-state arbitrations that appear to favor, or even expand, investor rights."* (White, The Argentine Financial Crisis: State liability under BITs and the legitimacy of the ICSID system, 2002)

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