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Jean Monnet Working Paper 06/08

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**Adjudging the Exceptional at International Law:
Security, Public Order and Financial Crisis**

This paper was also published as [IILJ Working Paper 2008/6](#)

NYU School of Law • New York, NY 10012
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www.JeanMonnetProgram.org

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ISSN 1087-2221
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New York University School of Law
New York, NY 10012
USA

Publications in the Series should be cited as:
AUTHOR, TITLE, JEAN MONNET WORKING PAPER NO./YEAR [URL]

**ADJUDGING THE EXCEPTIONAL AT INTERNATIONAL LAW:
SECURITY, PUBLIC ORDER AND FINANCIAL CRISIS**

JÜRGEN KURTZ^{*}

ABSTRACT

This paper examines the impact of international law on the ability of states to mitigate the effects of financial crises. It focuses on the invocation of investment treaty disciplines in the aftermath of the 2001-2 Argentine financial crisis and the adjudication of Argentina's defence of a state of necessity, under both subject treaties and at customary international law. The paper uncovers three interpretative methods in the jurisprudence on the relationship between the treaty exception and customary plea of necessity: methodologies I (confluence), II (*lex specialis*) and III (primary-secondary applications). Method I is the dominant approach in the jurisprudence and the most restrictive of the three readings. The paper argues that method I is mistaken both on a careful interpretation of the two legal standards and on a broader historical analysis of the emergence of investment treaty norms. Given these substantive flaws, the paper isolates the motivations to account for the popularity of this method through a close reading of the awards. These reveal continuing tensions in the field, not least the problematic suggestion that a single value of protection should exclusively inform our understanding of the purpose of investment treaties. These sociological features of investor-state arbitration should, it is suggested, inform our choice on other interpretative methods. This comes down to an election between methods II (*lex specialis*) and III (primary-secondary applications). Method III is the most convincing and coherent reading of the relationship between the two legal standards. The paper concludes by offering a framework to address the key interpretative questions implicated in that method: (i) the identification and scope of the notion of "public order" and a state's "essential security interests"; and (ii) the appropriate test of "necessity" or means-end scrutiny.

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I. INTRODUCTION

International law has, until recently, played a marginal role in the management of financial crises. Critical attention has instead focussed on the lending practices of international financial institutions and their contribution to outbreaks such as the debt crises of the 1980s, the Mexican peso crisis of 1994 and the Asian crises of 1997-1998.¹ The financial crisis that enveloped Argentina in late 2001 has revealed a new legal subject with the serious potential to constrain state autonomy in mitigating the effects of such crises. This is the network of international investment treaties that grant foreign investors the right to challenge signatory state laws for breach of treaty commitments in a range of arbitral institutions.² Foreign investors began with increasing urgency to invoke these broad treaty disciplines to challenge regulatory measures implemented by Argentina in the aftermath of its financial crisis.³ The early cases have largely ruled against Argentina and awarded significant monetary compensation to the claimant investors.⁴

These cases engage a treaty exception rarely adjudicated upon at international law that entitles a signatory state to pass emergency measures “necessary” for the maintenance of “public order” or the protection of “essential security interests”.⁵ This type of exception is not confined to international investment treaties and can be found in other *fora* at international law.⁶ Despite attracting academic comment in these other fields⁷, there has

¹ See, e.g., J.I. Levinson, *A Perspective on the Debt Crisis*, 4 AM. UNIV. J. INT’L L. & POL. 489 (1989); JOSEPH STIGLITZ, GLOBALIZATION AND ITS DISCONTENTS 89-133; 195-214 (2002); NEOLIBERALISM AND CONFLICT IN ASIA AFTER 9/11 (Garry Rodan & Kevin Hewinson eds., 2005).

² As of the end of 2006, state parties had concluded a total of 2573 bilateral investment treaties (BITs). Moreover, substantive investment commitments are increasingly found in various bilateral and regional trade agreements. These agreements numbered 241 at the end of 2006. See UNCTAD, *Recent Developments in International Investment Agreements*, UNCTAD Doc. UNCTAD/WEB/ITE/2007/6 IIA MONITOR No. 3 2, 6-7 (2007).

³ The total cumulative number of known investment treaty-based cases reached 290 at the end of 2007. Argentina has the highest number of claims of any state party in the system of investment treaty arbitration. There were a total of 46 claims against Argentina (at the end of 2007), 44 of which relate at least in part to that country’s financial crisis. See UNCTAD, *Latest Developments in Investor-State Dispute Settlement*, UNCTAD Doc. UNCTAD/WEB/ITE/IIA/2008/3 IIA MONITOR No. 1 1-2 (2008).

⁴ For example, five awards concerning Argentina were issued in 2007 and each them ruled against Argentina. Out of a total of US\$1,838 billion in claimed damages, the five tribunals awarded foreign investors a total of US\$615 million (approximately 33% of the claimed amount). *Id.* at 10.

⁵ Treaty Between the United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment, *signed* at Washington D.C., Nov. 14, 1991, *entered into force* Oct 20, 1994 [hereinafter U.S.-Argentina BIT], at Art. XI.

⁶ In particular, Article XXI of the General Agreement on Tariffs and Trade 1947 offers an exception for the protection of “essential security interests”. General Agreement on Tariffs and Trade, Oct. 30, 1947, TIAS No. 1700, 55 UNTS 194 [hereinafter GATT], Art. XX. For a comparative analysis of GATT Article XX and the treaty exception in the U.S.-Argentina BIT, see *infra* Part II(3.2).

been little direct jurisprudence surrounding this exception⁸. The cases to emerge from the Argentine financial crisis thus offer a unique opportunity to assess the scope and operation of this important treaty defence.⁹

The arbitral tribunals that have ruled against Argentina's invocation of the exception adopt a distinct, even remarkable interpretative approach. They draw extensively on customary principles of necessity (taken to be represented by the work of the International Law Commission) to guide their interpretation and application of the treaty exception. The stringent conditions of the plea of necessity in the ILC Articles on State Responsibility¹⁰ are applied as operative components of the treaty defence. The outcome in all but a few cases has been to refuse Argentina's claim to derogation of liability.

On first blush, these cases might simply be taken as part of the contemporary project of managing fragmentation of international law.¹¹ By weaving the treaty exception and customary plea together, the cases offer a visible rejoinder of the criticism that international

⁷ See, e.g., Michael J. Hahn, *Vital Interests and the Law of GATT: An Analysis of GATT's Security Exception*, 12 MICH. J. INT'L L. 558 (1991); Raj Bhala, *National Security and International Trade Law: What the GATT Says and What the United States Does*, 19 U. PA. J. INT'L ECON. L. 263 (1998); Hannes L. Schloemann & Stefan Ohlhoff, "Constitutionalization" and Dispute Settlement in the WTO: *National Security as an Issue of Competence*, 93 AM. J. INT'L L. 424 (1999); Wesley A. Cann, Jr, *Creating Standards and Accountability for the Use of the WTO Security Exception: Reducing the Role of Power-Based Relations and Establishing a New Balance Between Sovereignty and Multilateralism* 26 YALE J. INT'L L. 413 (2001).

⁸ GATT Article XXI has been examined in very general terms by four GATT panels that have offered little direct analysis of the scope of the exception for "essential security interests". For an overview of these cases, see Schloemann & Ohlhoff, *supra* note 7, at 426. Article XIV of the WTO General Agreement on Trade in Services carves out measures necessary to "maintain public order" and as such, has a similar textual component to the typical exceptions found in certain investment treaties. This Article has been considered in some detail by a WTO Panel and Appellate Body in the *Internet Gambling* case. For an analysis of this case and its relevance as guide to the interpretation of the public order component of an investment treaty exception, see *infra* Part V(2.1). Finally, the International Court of Justice has twice considered similar forms of exception in the *Nicaragua* and *Oil Platforms* cases respectively. For an analysis of those judgments and their implications for the argument advanced in this paper, see *infra* Parts II(3.2); III(3.1); IV(2.1).

⁹ There are few direct analyses of the implications of the interpretative methodology adopted in these cases. For three key analyses, see Andrea Bjorklund, *Emergency Exceptions: State of Necessity and Force Majeure*, in OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW (P. Muchlinski et. al. eds., 2008); William Burke-White & Andreas von Staden, *Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties*, 48 VA. J. INT'L L. 307-410 (2008); José E. Alvarez & Kathryn Khamsi, *The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime*, IILJ Working Paper 2008/5 <www.iilj.org>. For general analysis on the relationship between investment treaties and other sources of international law (with a short but careful account of the Argentine cases), see also Campbell McLachlan, *Investment Treaties and General International Law*, 57 INT'L COMP. L. Q. 361-401 (2008).

¹⁰ International Law Commission, Draft Articles on the Responsibility of States for Internationally Wrongful Acts with Commentaries, U.N. GAOR, 56th Sess., Supp. 10, Ch. 4, U.N. Doc. A/56/10 (2001) [hereinafter ILC Articles].

¹¹ *Report of the Study Group of the International Law Commission, Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law*, U.N. Doc. A/Cn.4/L.682 (Apr. 4 2006) [hereinafter ILC Fragmentation Report],

investment treaties are a self-contained regime at international law, divorced from a broader normative framework. After all, the resistance in early cases to using custom as a defining component of *other* treaty provisions - such as the obligation to accord fair and equitable treatment¹² – has proven contentious¹³ and even triggered the intervention (or use of voice) by state parties in certain settings¹⁴. This favourable, impressionistic view of the emerging jurisprudence on the treaty exception though is mistaken. As a recent Annulment Committee constituted in this area has noted, the arbitral tribunals to date neglect to rigorously examine the precise relationship between the treaty defence and customary plea.¹⁵

My principal aim in this paper is to uncover and analyze the key methodological possibilities of interpreting the treaty exception and its relationship to customary law. To do so, I adopt a particular methodology of my own. My analysis focuses on objective expressions of the function and purpose of the investment treaty regime and its connection to, and at times departure with, the customary law of state responsibility. Those objective expressions – reflected in the immediate treaty text, contextual indicators and a broader historical narrative – are prioritized in my analytical structure over evidence of the subjective intentions of the state parties and their negotiators. In this respect, my approach intentionally tracks the sequencing (and arguably ordering) of particular interpretative techniques as codified in the *Vienna Convention on the Law of Treaties* 1969.¹⁶ I do so as my theses are both descriptive

¹² As an example of this obligation, Article 1105(1) of the North American Free Trade Agreement requires the state parties “to accord to investments of investors of another Party treatment *in accordance with international law*, including fair and equitable treatment and full protection and security”. (emphasis added). North American Free Trade Agreement, Dec. 17, 1992, Can.-Mex.-U.S., 32 ILM 289 & 605 (1993), at Art. 1105.

¹³ *Compare Pope & Talbot v Canada*, UNCITRAL Arbitration Award on the Merits of Phase 2 (Apr. 10, 2001), at paras. 110-1; *SD Myers v Canada*, UNCITRAL Arbitration, Partial Award (Nov. 13, 2000), at paras 259-269 (both ruling that NAFTA Article 1105 adopts an additive component that extends beyond the scope of protection at customary international law) *with Judicial Review of Metalclad Arbitral Award by the Supreme Court of British Columbia* (May 2, 2001), at paras 64-6 (criticising the *Pope & Talbot* and *Myers* awards on the interpretation of NAFTA Article 1105 as ignoring the plain text of that treaty provision).

¹⁴ NAFTA Free Trade Commission, *Notes of Interpretation of Certain Chapter 11 Provisions* (July 31, 2001), at Parts B(1) and (2) (confirming that NAFTA Article 1105(1) “prescribes the customary international law minimum standard of treatment” and that “the concepts of ‘fair and equitable treatment’ and ‘full protection and security’ do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens”).

¹⁵ The *CMS Annulment Committee* ruled: “Those two texts have 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 Article XI and Article 25 are on the same footing.” See *CMS Gas Transmission Company v Argentine Republic*, ICSID Case No. ARB/01/8, Decision of the *Ad Hoc* Committee on the Application for Annulment, Sept. 25, 2007 [hereinafter *CMS Annulment Award*], at para 131. For analysis of the CMS Annulment Award, see Jürgen Kurtz, *ICSID Annulment Committee Rules on the Relationship Between Customary and Treaty Exceptions on Necessity in Situations of Financial Crisis*, 11 (30) ASIL INSIGHT (Dec. 20, 2007).

¹⁶ Article 31 of the *Vienna Convention on the Law of Treaties* requires, among other things, treaty provisions to be given their ordinary meaning, in context and in light of the treaty’s object and purpose. This is an obligatory

(identifying a flaw in the use of these rules in the dominant methodology to date) and normative (presenting a framework as to what tribunals should do in future cases). This is not to deny that in certain treaty settings, differentiated hermeneutics (such as a search for the subjective intention of the parties) may offer critical guidance to an adjudicator.¹⁷ On the whole, the network of bilateral investment treaties (BITs) seems, perhaps counter-intuitively, ill-equipped for delving into originalist interpretation. We are dealing with a device not unlike a standard-form contract employed in a domestic setting; BITs typically follow a model form offered by a (strong) regulation maker to an (at times, weak) regulation taker.¹⁸ This translates into a surprising lack of evidence on the part of the regulation taker as to their intentions in entering into the treaty device.¹⁹ The temptation is then to draw on the extensive evidence of the strong player as entirely conclusive of the common intention of the parties.²⁰ This inevitably cashes out into a deterministic claim of such treaties as devoted *solely* to investment protection where in fact the silence of the regulation taker may mask multiple, even conflicting goals.²¹

sequencing of interpretative methods and devices. On the other hand, resort to *travaux préparatoires* (or other evidence of the intentions of the parties) may, according to Article 32, only be used to confirm a meaning from other sources (that is, the Article 31 route) or where application of Article 31 results in ambiguity or a result which is “manifestly absurd or unreasonable”. Vienna Convention on the Law of Treaties, 1155 U.N.T.S. 331 *reprinted in* 8 I.L.M. 679 (1969) [hereinafter VCLT], at arts. 31-2.

¹⁷ I am grateful to Joseph Weiler for discussions on this point. For a sustained argument as to the merits of drawing on evidence of drafting history in interpreting the 1951 Refugee Convention, see JAMES HATHAWAY, *THE RIGHTS OF REFUGEES UNDER INTERNATIONAL LAW* 49-74 (2005).

¹⁸ For an excellent and careful analysis of the use of model treaty text by the U.S in this field, see Alvarez & Khamsi, *supra* note 9, at 26-34.

¹⁹ The lack of evidence of Argentina’s intentions in entering into the U.S-Argentina BIT was in fact noted by and analysed in the recent *Continental* award. See *Continental Casualty Company v Argentine Republic*, ICSID Case no. ARB/03/9, Sept. 5, 2008 [hereinafter *Continental Award*], at paras 182-7 (and footnote 279).

²⁰ This is a marked and frank characteristic of the Alvarez and Khamsi analysis of the U.S-Argentine BIT and its adjudication in the aftermath of the Argentine financial crisis. Consider the two following suggestions made by those authors:

The “uncompromising” posture of the United States with respect to BIT negotiations during this period means that, absent contrary evidence, the drafting intent of the United States and the history of its BIT program is highly relevant to the interpretation of this treaty.

It appears that all parties in these cases relied heavily on evidence from the United States. This is not surprising since the United States was the drafter of the model treaty on which the treaty was based. There was presumably no contrary evidence of a distinct Argentine intent (which would presumably be easy for Argentina to acquire) simply because no contrary evidence of intention or object and purpose exists.

Alvarez & Khamsi, *supra* note 9, at 32 and 34.

²¹ This complex dimension deserves careful and extended attention in its own right. Let us though take one short illustration from the factual matrix surrounding Argentina’s entry into the BIT at issue in these cases. It is doubtful that for Argentina, given past evidence of hostility to foreign capital and the cluster of initiation and peak activity of its BIT program throughout the 1990s, that protection of investment was ever a *per se* value, an end in itself. Entry into BITs instead represented a signalling device, communicating an underlying policy and developmental shift to private economic actors and other institutional agents (such as lending institutions). Protection in these terms is thus intimately tied to (and even contingent on) a broader, nuanced objective. For analysis of the role of the Argentine BIT program in these terms, see *infra* Part II(1).

I begin the next Part II by tracing the factual matrix surrounding Argentina's entry into this unique area of international law, the outbreak of the financial crises and the abrogation of contractual rights that triggered the initiation of investor claims for compensation. Readers familiar with this complicated but essential fact-set may wish to proceed directly to Part II(3). There I begin my substantive analysis of the text and history of the operative legal standards examined in the jurisprudence respectively, Article XI of the U.S-Argentina Bilateral Investment Treaty and the project of development (and perhaps even reflection) of the customary plea of necessity in ILC Article 25.

Turning to the cases, there are to my mind three methodologies open to an adjudicator in understanding the relationship between the treaty exception and the customary plea of necessity. These can be termed respectively methodologies I (confluence), II (*lex specialis*) and III (primary-secondary applications). Method I is clearly the dominant approach in the jurisprudence to date, whereby tribunals expressly conflate the treaty defence with the customary plea of necessity. This, I argue, is mistaken both on careful interpretation of these legal standards but also on an investigation of the complex and nuanced history of the shift from customary to treaty protections for foreign investors. Given its popularity in the jurisprudence, there is an important question as to why the arbitrators in these cases would choose to conflate the two legal standards. This is a difficult question to answer conclusively as the party pleadings and transcript of proceedings have not been made public.²² None the less, a close analysis of the awards themselves reveals a set of intriguing clues as to possible and at times, troubling motivations at play in the adoption of this flawed approach. This part of the paper is not intended to be self-standing as an insight into broader tensions surrounding this field. Instead, the particular sociological features of arbitral dispute settlement²³ should, I suggest, inform our choice on other methods of interpreting the treaty standard vis-à-vis the customary norm.

Part IV introduces an alternate methodology of reading the treaty exception as an expression of *lex specialis*. Unlike method I, this approach has the distinct advantage of at least presenting a plausible account of the relationship between the treaty defence and customary

²² This is in striking contrast to certain arbitrations under the investment chapter 11 of the NAFTA such as *UPS v Canada* and *Methanex v U.S.A* where both the pleadings and transcript of proceedings are publicly available and offer important insights into the deliberations of the parties and tribunals in those cases.

²³ For my working definition of sociological inquiry in this context, see *infra* Part III(3).

plea. There is though an open interpretative question of the scope of priority to be accorded to the treaty defence under this reading, which has largely been ignored by those sympathetic to this reading.²⁴ The flirtation with *lex specialis* in the jurisprudence fails to engage a critical choice between applying custom in a residual fashion (where not in conflict) or displacing it in its entirety. At its most fundamental, a *lex specialis* reading could see the stringent customary test of means-end scrutiny continue to guide the question of the “necessity” of a signatory state’s chosen means. This would render the treaty exception inutile, in all but the most exceptional circumstances.

In the final part of the paper, I offer a third methodology to overcome the inherent deficiencies of the earlier approaches. The taxonomy of method III (primary-secondary applications) separates questions of wrongfulness and state responsibility at international law. It characterizes all of the treaty provisions at issue – both forms of obligation and exception – as primary legal standards that determine whether a state has committed a wrongful act at international law. Under this approach, it is *only* if breach is determined by the composite application of these treaty rules, that an adjudicator should examine the secondary possibility of the customary plea of necessity to preclude wrongfulness as a matter of state responsibility. The key implication of my preferred method III is to require an adjudicator to attend to interpretation of key aspects of the treaty defence without simply borrowing or transplanting from the customary plea. This has important doctrinal and normative advantages, not least as a means of responding to the concern that investment treaties represent a classic embodiment of incomplete contracting. The logical implication though of method III is to raise a host of difficult interpretative questions surrounding the treaty exception and the paper concludes by offering an interpretative framework to future tribunals charged with that challenge.

II. THE ARGENTINE FINANCIAL CRISIS AND INVESTOR-STATE LITIGATION

To assess Argentina’s claim to derogation of liability at international law, it is essential that we have an accurate indication of its response to the crisis as well as the causes and magnitude of that event. Many of the underlying legal categories at issue – particularly the “necessity” of chosen means to effect permitted regulatory ends – require an adjudicator to examine and test the rationality of the regulatory record as a whole.

²⁴ See, e.g., Burke-White & von Staden, *supra* note 9, at 322; McLachlan, *supra* note 9, at 390.

1. The Crisis and Argentina's Regulatory Response

Our starting point in uncovering the factual record should begin before the onset of the financial crisis in late 2001. The advantages enjoyed by foreign investors and rendered inutile by Argentina's response to the crisis (together with their rights at international law) have their origins in a broader macroeconomic change initiated in 1991. That year saw Argentina implement its Convertibility Law that fixed the exchange rate of the austral (the then Argentine currency) with the U.S dollar.²⁵ The goal was to constrain the spiral of hyperinflation and relative stagnation that had plagued the Argentine economy since the 1960s.²⁶ The strategy was one of intentional "hands tying" on the part of the Argentine Government. Convertibility prevented monetary authorities from simply increasing monetary supply depending on shifts in economic conditions, with resulting inflationary effects. The Government was instead required to keep enough U.S dollars in reserve to support the total amount of domestic currency in circulation.

In the early 1990s, Argentina initiated an extensive privatization program. By 1994, over 90 per cent of state enterprises had been privatised including the telephone, electricity, gas and water utilities.²⁷ The policy shift to privatisation was linked to the convertibility strategy. As this required continuing reserves of foreign capital, the funds garnered through privatisation were used to bolster convertibility of the Argentine peso.²⁸ Argentina though faced a reputational overhang in its project of attracting the entry of foreign investment into these sectors.²⁹ There were two distinct mechanisms used by Argentina to signal its break from

²⁵ Jorge Schvarzer, *The Costs of the Convertibility Plan*, in *BROKEN PROMISES? THE ARGENTINE CRISIS AND ARGENTINE DEMOCRACY* 71-73 (Edward Epstein & David Pion-Berlin eds., 2006).

²⁶ *Id.* (detailing average annual inflation of 25% in the period 1960 to 1974 rising to 35% in the period 1975 to 1991 with no growth in GDP).

²⁷ See PAUL BLUSTEIN, *AND THE MONEY KEPT ROLLING IN (AND OUT): WALL STREET, THE IMF AND THE BANKRUPTING OF ARGENTINA* 23-4 (2005).

²⁸ In fact, the Argentine government targeted foreign investors as preferred entrants into newly privatized utility sectors. This strategy is discussed in detail in the factual record of the *LG&E* ruling. See *LG&E Energy Corp, LG&E Capital Corp, LG&E International Inc v Argentine Republic*, ICSID Case No. ARB/02/1, Award, Oct. 3, 2006 [hereinafter *LG&E Award*], para 49.

²⁹ Argentina has a long history of defaulting on its foreign debt obligations. See generally CARLOS MARICHAL, *A CENTURY OF DEBT CRISES IN LATIN AMERICA* (1989); ERNEST OLIVERI, *LATIN AMERICAN DEBT AND THE POLITICS OF INTERNATIONAL FINANCE* 163-203 (1992). Moreover, a range of Argentine jurists and diplomats have actively sought to influence the content of international law to limit the ability of external lenders (and their states) to collect on defaulted sovereign obligations. Carlos Calvo, an Argentine jurist of the late nineteenth century posited an influential thesis that aliens (including foreign economic actors) were entitled only to the standard of protection domestic nationals receive under domestic law and legal systems. Domestic courts, in turn, were the only forum competent under this theory to hear the complaints of an aggrieved foreign actor.

past practices. First, it offered a range of specific incentives to private companies who acquired ownership interests in various utility sectors.³⁰ Tariffs were to be calculated in U.S dollars, conversion to pesos occurred at the time of billing and most crucially, tariffs were to be adjusted every six months under a key U.S inflation index (the U.S Producer Price Index).³¹ Secondly, Argentina entered into a range of bilateral investment treaties (BITs) throughout the 1990s.³² These treaty instruments include the 1991 U.S-Argentina BIT which was invoked by a range of U.S investors following the financial crisis.³³

BITs offer a range of specific guarantees of protection to foreign investors to mitigate the risk of operation in a host state.³⁴ These include key obligations of non-discrimination³⁵, a commitment on the part of the signatory state to accord “fair and equitable treatment” to a foreign investor³⁶ and a guarantee that the signatory state compensate the foreign investor for takings of foreign assets³⁷. Critically, these treaties usually displace the customary rule that a home state of an investor must elect to exercise diplomatic protection on behalf of the investor.³⁸ Instead, a foreign investor is granted the right to bring a claim for breach of a treaty directly against a signatory host state.³⁹ There are various systems of adjudication presented in a typical BIT. One of the most active of these – and later invoked against

In the event that a state chose to treat both domestic and foreign actors poorly, there was no specific right of recourse for the home state of the foreign actor under this account of international law. *See generally* Amos S. Hershey, *The Calvo and Drago Doctrines*, 1 AM. J. INT’L L. 26, 26-7 (1907).

³⁰ The Economist described these incentives in a special report on the Argentine financial crisis in the following terms: “[Then Argentine President] Menem’s privatisations involved sweetheart deals. Telecoms, electricity, water and some transport services became private rather than public monopolies; their tariffs, on long-term contracts, went up in line with American inflation, even though prices in Argentina were falling.” *A Decline without Parallel – Argentina’s Collapse*, THE ECONOMIST, Special Report, Mar. 2, 2002.

³¹ *CMS Annulment Committee Award*, *supra* note 15, at para 34.

³² For a useful chart of Argentina’s overall BIT program showing initiation and peak activity throughout the 1990s, see Zachary Elkins, Andrew Guzman & Beth Simmons, *Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000* 60 INT’L ORG. 811, 821 (figure 5) (2006).

³³ U.S-Argentina BIT, *supra* note 5.

³⁴ For recent discussion of the typical protections found in investment treaties, see RUDOLF DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* (2008); CAMPBELL MCLACHLAN ET AL., *INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES* (2007).

³⁵ *See, e.g.*, U.S.-Argentina BIT, *supra* note 5, at Art. II(1) (obligation to accord foreign investors both national and most-favored-nation treatment)

³⁶ *Id.* at Art. II(2)(a).

³⁷ *Id.* at Art. IV.

³⁸ For detailed analysis of the customary rules on diplomatic protection and their displacement in modern investment treaties, *see infra* Part II(2.2).

³⁹ U.S-Argentina BIT, *supra* note 5, at Art. VII.

Argentina – is the World Bank’s Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (ICSID).⁴⁰

Up until 1995, the Argentine policy shift had generated significant positive outcomes. There was significant entry of foreign investment and inflation had subsided to levels Argentines had not seen in decades⁴¹ combined with sizeable rates of annual economic growth⁴². Circumstances began to change by the late 1990s. Successive financial crises in Asia (1997) and Russia (1998) showed that foreign lenders of debt capital could quickly withdraw funds from recipient states. Those lenders continued to provide capital to Argentina, thereby consolidating convertibility, but began to demand significantly higher yields on their investment.

A tipping point was reached in late 1998 due to a range of exogenous factors.⁴³ Confidence in the economy began to weaken with investors electing to withdraw capital. In late 2000 and early 2001, the Argentine government sought to buttress convertibility by arranging for emergency loan finance from the IMF.⁴⁴ It offered external lenders the possibility of a voluntary debt swap in an attempt to hold off devaluation of the peso.⁴⁵ By July 2001, Argentina had moved to a drastic zero deficit position; it reduced government spending – including cuts of 13% in government salaries and pensions – in an attempt to prevent the need to further borrow external funds.⁴⁶

These efforts to stave off devaluation proved futile. There was a run on the domestic banking system in November 2001 as depositors lined up to withdraw 6 per cent of total bank deposits

⁴⁰ Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, *opened for signature* Mar. 18, 1965, 17 U.S.T. 1270, T.I.A.S. No. 6090, 575 U.N.T.S. 159 (*entered into force* Oct. 14, 1966) [hereinafter ICSID Convention].

⁴¹ BLUSTEIN, *supra* note 27, at 21 (detailing the inflation rate of 17.5 percent in 1992, falling to 7.4 percent in 1993, 4.2 percent in 1994 and then to “virtually zero” for the rest of the 1990s).

⁴² *Id.* at 21-4 (detailing 10 percent annual increase in GDP in 1991 and 1992, followed by 6.3 percent growth in 1993 and 5.8 percent in 1994).

⁴³ There was a sharp fall in the international price of key agricultural goods exported by Argentina (especially soybeans and grain). In 1999, Brazil – Argentina’s principal trading partner – devalued its currency leading to a 28% drop in Argentine exports to Brazil. This period also witnessed a rise in the value of the U.S dollar that in turn elevated the peso, further diminishing the export competitiveness of key Argentine goods. Schvarzer, *supra* note 25, at 84.

⁴⁴ See generally BLUSTEIN, *supra* note 27, at 83-106.

⁴⁵ Under this arrangement, Argentina’s bondholders would swap bonds due for payment for others of longer maturation but with a higher interest rate. The objective – from Argentina’s perspective – was to postpone the payment of interest and principal under the original bonds. *Id.* at 124-34.

⁴⁶ *Id.* at 136-7.

over three days.⁴⁷ The Government responded with the ‘corralito’, a freeze on bank withdrawals. As account holders could only withdraw the equivalent of US\$250 in cash per week, domestic economic activity began to grind to a halt particularly in vulnerable sectors that rely on cash transactions (including the self-employed).⁴⁸ These progressively harsh measures generated significant popular unrest with outbreaks of riots and looting leading to a score of fatalities. From December 2001 to January 2002, five different presidents were appointed in a ten-day period.⁴⁹ By January 2002, 25 percent of the urban workforce was unemployed with a majority of the population below the official poverty line.⁵⁰ The Government responded to this dire situation by officially abrogating convertibility through an Emergency Law whereby the peso immediately declined in value by almost 70 per cent.⁵¹

The Emergency Law also targeted licensees in various utility sectors, giving rise to the later legal claims of foreign investors in those sectors. These measures comprised two, related elements. Tariffs would now be assessed in devalued pesos rather than in U.S dollars and adjustment of those tariffs in line with U.S inflation indices was terminated.⁵²

2. The Onset of Litigation

The financial losses to flow from Argentina’s Emergency Law have triggered dozens of claims by foreign investors alleging breach of Argentina’s investment treaty obligations. Argentina has invoked defined treaty exceptions and customary law in an attempt to claim abrogation of liability. The invocation of the exceptions is the focus of our inquiry (rather than the question of breach of operative standards of liability).

There have been five “first instance” arbitral awards that have directly considered the relationship between the customary and treaty exceptions invoked by Argentina. These cases were all initiated within the ICSID system and concern the same subject treaty, being the 1991 U.S-Argentina BIT.⁵³ There is an initial cluster of four awards; *CMS v Argentina* (May

⁴⁷ *Id.* at xx.

⁴⁸ The Economist, *supra* note 30.

⁴⁹ BLUSTEIN, *supra* note 27, at 1.

⁵⁰ The Economist, *supra* note 30.

⁵¹ *Continental*, *supra* note 19, at para 142.

⁵² *CMS Annulment Award*, *supra* note 15, at para 36.

⁵³ They all, bar *Continental*, also track a similar fact-set involving foreign investment into utility concerns in the aftermath of the Argentine privatization program. *Continental* concerns the adverse impact of pesification on the portfolio of investment maintained by an insurance company in Argentina (with foreign ownership). The

2005)⁵⁴, *LG&E v Argentina* (October 2006)⁵⁵, *Enron v Argentina* (May 2007)⁵⁶ and *Sempra v Argentina* (September 2007)⁵⁷. The *CMS*, *Enron* and *Sempra* Tribunals rule against Argentina and adopt similar methods of reasoning. The *LG&E* Tribunal on the other hand, partially finds in favour of Argentina on its invocation of the exceptions. What follows is the release of a ruling by an ICSID Annulment Committee on the *CMS* award. There is no formal system of appellate review on questions of law within the ICSID but an unsuccessful party can apply for annulment on narrow grounds essentially reflecting due process failures.⁵⁸ While largely finding against Argentina, the Annulment Committee – in many ways adopting the language and gravitas of an appellate judicial body⁵⁹ - offers a range of targeted criticisms of the legal reasoning adopted by the *CMS* Tribunal.⁶⁰ The final and fifth instalment (to date) is the *Continental v Argentina* (September 2008) award ruling largely in favour of Argentina, with a distinct method of its own.

These five rulings engage fundamentally different and at times, conflicting methods of interpreting the relationship between the operative treaty exception and relevant customary law. Before entering this complex jurisprudential mix, it is essential that we have a clear understanding of the key operative legal standards in question.

3. The Operative Legal Standards

3.1 *The Plea of “Necessity” at Customary International Law*

difference in fact-set is not, to my mind, material to the adjudication on the relationship between the treaty exception and the customary plea and as such, there is little attention devoted to this point in my analysis.

⁵⁴ *CMS Gas Transmission Company v Argentine Republic*, ICSID Case No. ARB/01/8, Award, May 12, 2005 [hereinafter *CMS Award*].

⁵⁵ *LG&E Award*, *supra* note 28.

⁵⁶ *Enron Corporation Ponderosa Assets L.P v Argentine Republic*, ICSID Case No. ARB/01/3, Award, May 22, 2007 [hereinafter *Enron Award*].

⁵⁷ *Sempra Energy International v Argentine Republic*, ICSID Case No. ARB/02/16, Award, Sept. 28, 2007 [hereinafter *Sempra Award*].

⁵⁸ ICSID Convention, *supra* note 40, at Art. 52(1) (setting out the five grounds for annulment as: (a) tribunal was not properly constituted; (b) manifest excess of powers; (c) corruption; (d) serious departure from a fundamental rule of procedure; (e) failure to state reasons).

⁵⁹ One can only speculate that this is perhaps natural given the make-up and credentials of the membership of that Committee. This comprised Judge Gilbert Guillaume (a former President of the ICJ), Judge Nabil Elaraby (a former judge of the ICJ) and notably, Professor James Crawford (ILC Special Rapporteur on State Responsibility).

⁶⁰ *CMS Annulment Award*, *supra* note 15, at paras. 101-50.

The ICSID tribunals constituted in the Argentine cases draw heavily on customary international law in determining Argentina's liability. The question then is whether custom offers some form of defence that would excuse state liability in exceptional circumstances such as financial crises. This raises an initial methodological question of where an adjudicator should look in determining the existence of such a customary rule. Custom comprises state practice coupled with a conviction (*opinio juris*) that the practice reflects a legal obligation.⁶¹ The identification of the requisite elements of custom has, in certain settings, proven to be a difficult conceptual exercise.⁶² None the less, one might expect the tribunals as a starting point to at least attempt to identify primary sources in assessing the existence of such an exceptional defence.⁶³

The tribunals do not engage in such a search but instead accept the International Law Commission's (ILC) Articles on the Responsibility of States for Internationally Wrongful Acts as constituting customary international law.⁶⁴ This is perhaps not surprising on two fronts. The ILC was established in 1947 by the United Nations General Assembly with the explicit objective of the progressive development of international law and its codification.⁶⁵ The topic of state responsibility was selected as an early candidate in the work of the ILC and it has produced multiple reports under the auspices of different rapporteurs in this difficult area. That work has itself been accepted as codifying custom by a range of international tribunals including the ICJ.⁶⁶

There remains though a legitimate question of whether the work of the ILC *should* be taken as a final expression of customary law in this area. For one thing, there has been no attempt

⁶¹ For an overview of the constituent components of customary international law, see ANTONIO CASSESE, *INTERNATIONAL LAW* 156-65 (2nd ed, 2005).

⁶² See, e.g., *Military and Paramilitary Activities (Nicar. v U.S.)*, I.C.J. 14 (June 27) [hereinafter *Nicaragua*], at paras 183-6 (ruling that inconsistent state practice need not bar the emergence of a customary prohibition on the use of force by states provided that such instances of state conduct "have been treated as breaches of that rule, not as indications of the recognition of a new rule").

⁶³ For an example of the use of case-law to distil the elements of the customary plea of necessity, see BIN CHENG, *GENERAL PRINCIPLES OF LAW AS APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS* 69-77 (1953).

⁶⁴ ILC Articles, *supra* note 10.

⁶⁵ G.A. Res. 174 II, (Nov. 21, 1947). On the work of the ILC, see generally Shabtai Rosenne, *Codification of International Law*, 1 *ENCYCLOPAEDIA OF PUBLIC INTERNATIONAL LAW* 632-40 (Rudolf Bernhardt ed., 1992).

⁶⁶ See, e.g., *Advisory Opinion, Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory*, 2004 I.C.J. 131 (July 9), at paras 140-2 (drawing on ILC Article 25 in its discussion of the state of necessity at customary international law); *United Postal Service of America Inc. v Government of Canada*, ICSID Arbitration, Award on the Merits (May 24, 2007), at paras. 45-76 (identifying the rules on attribution in ILC Articles 4 and 5 as representing customary international law).

to transform the ILC Articles into a treaty through a diplomatic law-making conference.⁶⁷ David Caron has also argued that several of the broad (and often controversial) ILC Articles are better viewed as part the “progressive development” of international law.⁶⁸ This would see them as “an authoritative scholarly statement of the law that would provide some guidance and clarity, yet also grow and change as it confronted the tests that the world presents”.⁶⁹ Investing them with the status of a formal source of law, on the other hand, would obviate this flexibility as adjudicators would confer excessive authority to the ILC Articles. Caron’s concern, expressed in 2002, is prescient given the inflexible application of the ILC Articles in the method of confluence adopted in many of the Argentine cases.

If we accept however, along with the ICSID tribunals, that the work of the ILC codifies customary international law, then Article 25 is our first potential legal standard. Given the extensive reliance on that Article by many of these tribunals, it is worth extracting it in its entirety:

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.⁷⁰

It is important to give careful consideration to the precise scope of operation of this provision. Along with a number of other provisions in Chapter V of the ILC Articles, this Article sets out particular circumstances that will *preclude* a wrongful act at international law.⁷¹ Those

⁶⁷ The articles were forwarded to the United Nations General Assembly by the ILC after its 2001 session. In Resolution 56/83, the General Assembly “takes note of the articles” and then “commends them to the attention of Governments without prejudice to the question of their future adoption or other appropriate action”. GA Res. 56/83 (Dec. 12, 2001).

⁶⁸ David D. Caron, *The ILC Articles on State Responsibility: The Paradoxical Relationship Between Form and Authority*, 96 AM. J. INT’L L. 857, 858 (2002).

⁶⁹ *Id.* at 861.

⁷⁰ ILC Articles, *supra* note 10, Art. 25.

⁷¹ The six circumstances precluding wrongfulness comprise: (i) consent, (ii) self-defence, (iii) countermeasures, (iv) force majeure, (v) distress and (vi) necessity. *See id.* at Chp. V.

clauses are thus logically predicated on the initial finding of a wrongful act at international law.

The current ILC Articles do not themselves define what will constitute a wrongful act. This is not accidental but instead represents an intentional departure from earlier ILC efforts to codify substantive principles of state responsibility. ILC Rapporteur García Amador produced a series of six reports from 1956 to 1961 that attempted the ambitious and difficult task of codifying the primary, substantive rules that would trigger state responsibility for injuries to aliens.⁷² These included the politically charged issue of whether states were required to compensate foreign actors for nationalization of private property even when linked to decolonisation processes. The difficulty of reaching agreement in this highly contested area drove a distinct shift in perspective and strategy in the operation of the ILC in the early 1960s. A new ILC Rapporteur, Roberto Ago, began work on *secondary* rules of state responsibility that would only apply on the finding of a wrongful act at international law.⁷³ These rules did not themselves identify what would constitute the wrongful act in the sense of operative rights and obligations. They instead provide the framework for determining whether primary obligations have been breached (such as the key issue of attribution of conduct to a state) together with the consequences that will flow at international law generally from a wrongful act.⁷⁴

The current ILC rules - finalized by Rapporteur James Crawford in 2001 - also adopt this taxonomy. The question of wrongfulness is assessed by the primary rules of international

⁷² See, e.g. F.V. García Amador, Special Rapporteur, *Responsibility of the State for Injuries Caused in its Territory to the Person or Property of the Alien, Part II: The International Claim, Third Report on State Responsibility*, U.N. Doc. A/CN.4/111, in 2 Y.B. INT'L L. COMM'N 47 [1958]. For a careful analysis of the work of the ILC, see Bjorklund, *supra* note 9.

⁷³ Antonio Cassese has elegantly described this shift in the following terms:

[T]he law of State responsibility has been *unfastened from the set of substantive rules on the treatment of foreigners*, with which it had been previously bound up. Chiefly R Ago must be credited for this major clarification of the matter. It is now generally acknowledged that a distinction can be made between '*primary rules*' of international law, that is those customary or treaty rules laying down substantive obligations for States (on State immunities, treatment of foreigners, diplomatic and consular immunities, respect for territorial sovereignty, etc.), and '*secondary rules*', that is, rules establishing on (i) on what conditions a breach of a 'primary rule' may be held to have occurred and (ii) the legal consequences of the breach. This latter body of international rules encompasses a separate and relatively autonomous body of international law, the law of State responsibility.

CASSESE, *supra* note 61, at 244.

See also Robert Rosentock, *The ILC and State Responsibility*, 96 AM. J. INT'L L. 792 (2002) (linking Roberto Ago's focus on secondary rules to a desire to avoid "the bigger fights over nationalization").

⁷⁴ On this distinction between "primary" and "secondary" rules, see generally J Combacau & D Alland, *Primary and Secondary Rules in the Law of State Responsibility: Categorizing International Obligations*, 16 NETH. Y.B. INT'L L. 81 (1995).

law applied to a given fact-set, an essential precondition to the invocation of the ILC rules.⁷⁵ It is also exclusively a question for the substantive legal regime at issue, whether customary or conventional in origin. A breach of these primary obligations constitutes a wrongful act that in turn, triggers the operation of the Articles in ILC Chapter 5.⁷⁶ Those articles, including Article 25 on “necessity”, offer the secondary possibility of precluding wrongfulness as a matter of international law. ILC Article 25 then acts a general defence that can apply to *any* international legal obligation. The Article itself confirms this expansive coverage; aside from the strict constituent elements of the defence of necessity in Article 25, its operation is only precluded if “the international obligation in question excludes the possibility of invoking the exception”.⁷⁷ This is a reflection of the important finding by a Chamber of the ICJ in the *ELSI* case that custom continues to apply (in its proper sphere of operation) to treaty obligations unless there are express words dispensing of a particular rule.⁷⁸

Given this expansive operation, it is entirely understandable that ILC Article 25 sets out a range of highly stringent conditions for the secondary plea of necessity to apply. This is also driven by the concern of potential abuse common to any form of derogation.⁷⁹ For example, Article 25 only authorizes a state to safeguard an “essential interest against a grave and imminent peril”. On the one hand, there is no qualification that a state’s essential interests be

⁷⁵ In the General Commentary to the ILC Articles, the following is made abundantly clear: “[I]t is not the function of the articles to specify the content of the obligations laid down by particular primary rules, or their interpretation...The articles take the existence and content of the primary rules of international law as they are at the relevant time..”. ILC Articles, *supra* note 10, at 31.

⁷⁶ See JAMES CRAWFORD, THE INTERNATIONAL LAW COMMISSION’S ARTICLES ON STATE RESPONSIBILITY: INTRODUCTION, TEXT AND COMMENTARIES 185 (2002) (affirming that “as embodied in article 25, the plea of necessity is not intended to cover conduct which is in principle regulated by the primary obligations”).

⁷⁷ ILC Articles, *supra* note 10, Art. 25(2)(a).

⁷⁸ The ICJ Chamber ruled as follows:

The United States questioned whether the [customary] rule of the exhaustion of local remedies could apply at all to a case brought under Article XXVI of the FCN Treaty. That Article, it was pointed out, is categorical in its terms and unqualified by any reference to the local remedies rule; and it seemed right therefore to conclude that the parties to the FCN Treaty had they intended the jurisdiction conferred upon the Court to be qualified by the local remedies rule in cases of diplomatic protection, would have used express words to that effect...*Yet the Chamber finds itself unable to accept that an important principle of customary international law should be held to have been tacitly dispensed with, in the absence of any words making clear an intention to do so.* This part of the United States response to the Italian objection must therefore be rejected. (emphasis added)

Elettronica Sicula S.p.A (ELSI) (U.S. v Italy), 1989 I.C.J. 15 (July 20), para 50 [hereinafter *ELSI*].

⁷⁹ See CRAWFORD, *supra* note 76, at 178 (noting that the special features of the plea mean that “necessity will only rarely be available to excuse non-performance of an obligation and that it is subject to strict limitations to safeguard against potential abuse”).

limited to traditional national security concerns such as the outbreak of inter-state hostility.⁸⁰ None the less, the interest itself must have a degree of seriousness (gravity) and be subject to temporal demands (imminence). This though is not the greatest limitation on the customary plea of necessity. That is reserved for ILC Article 25(1)(a) which requires that the chosen governmental measure (“act”) be the “only way” for a state to meet that objective.

There is no inherent, natural meaning of when a particular measure will be necessary to achieve a given end. This has been the subject of analysis within the jurisprudence on a similar sort of exception in the law of the World Trade Organization (WTO). Articles XX(a), (b) and (d) of the General Agreement on Tariffs and Trade (GATT) require an otherwise GATT-inconsistent measure to be “necessary” for certain ends in order to avoid liability.⁸¹ The WTO Appellate Body in the *Korea-Beef* case presented the interpretative options on the term “necessary” in GATT Article XX(d) across a spectrum:

We believe that, as used in the context of Article XX(d), the reach of the word “necessary” is not limited to that which is “indispensable or “of absolute necessity” or “inevitable”. Measures which are indispensable or of absolute necessity or inevitable to secure compliance certainly fulfil the requirements of Article XX(d). But other measures, too, may fall within the ambit of this exception. As used in Article XX(d), the term “necessary” refers, in our view, to a range of degrees of necessity. At one end of this continuum lies “necessary” understood as “indispensable”; at the other end, is “necessary” taken to a mean as “making a contribution to”.⁸²

Unlike GATT Article XX(d), there is no continuum of meanings in the application of the customary plea of “necessity”. ILC Article 25(1)(a) supplies the operative test; the chosen means must be indispensable as the “only way” for the state to safeguard its essential interests. Where there are multiple options open to a state, the customary defence is simply precluded. In the few occasions where the customary plea has been raised at international law, it is this strict test of means-end scrutiny that has been applied to defeat invocation of the plea.⁸³ The origins of this exceedingly stringent test lie in the claim of necessity surrounding

⁸⁰ According to ILC Special Rapporteur James Crawford: “The extent to which a given interest is ‘essential’ depends on all the circumstances, and cannot be prejudged. It extends to particular interests of the State and its people, as well as of the international community as a whole.” *Id.* at 183.

⁸¹ GATT, *supra* note 6, at Art. XX.

⁸² *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R, WT/DS169/AB/R, Report of the Appellate Body (Dec. 11, 2000), at para. 161.

⁸³ See, e.g., *Libyan Arab Foreign Investment Company v Republic of Burundi*, Ad Hoc Arbitration, 96 INT’L L. REP. 279, 319 (Mar. 4, 1991) (“[T]he various measures taken by that State against the rights of the shareholder LAFICO do not appear to the Tribunal to have been the only means of safeguarding an essential interest of Burundi against a grave and imminent peril.”); *Case Concerning the Gabčíkovo-Nagymaros Project (Hung. v. Slov.)*, 1997 I.C.J. 7 (Sep. 25), para 56 (“The Court moreover considers that Hungary could, in this context also,

the use of force in self-defence.⁸⁴ In the famous 1841 Caroline controversy between the United States and Great Britain, U.S Secretary of State Daniel Webster observed that in order for a state to act in anticipatory self-defense, there must be a “necessity of self-defense, instant, overwhelming, leaving *no choice of means* and no moment for deliberation” (emphasis added).⁸⁵ Here we have in a nutshell the danger of formalizing or applying a general legal rule without careful attention to the context of its emergence. It is perhaps sensible to advocate for such a stringent test to the use of force between states. It is questionable though whether the same sort of strict means-end scrutiny should apply to *all* other areas of extraordinary state action.

3.2 *The Treaty Exception:*

Article XI of the U.S.-Argentina Bilateral Investment Treaty

The five cases that are the subject of this paper engage the same treaty exception, Article XI of the 1991 Argentine-US BIT. That exception is nested within an overall treaty regime that imposes significant obligations on a state party in their dealings with foreign investors of the other signatory state.⁸⁶ The treaty as a whole then prescribes the sort of primary rules whose application might lead to a finding of a wrongful act at international law. This is the predicate for the invocation of the customary plea of necessity in the taxonomy of the ILC.

Article XI of the U.S-Argentina BIT itself is remarkably brief and simply provides:

This 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 restoration of international peace or security, or the protection of its own essential security interests.⁸⁷

The treaty provision thus encompasses three permitted regulatory objectives; (1) public order; (2) obligations with respect to the maintenance or restoration of international peace or security; (3) essential security interests. A chosen measure of a signatory state must also be “necessary” to achieve those goals.

have resort to other means to respond to the dangers it apprehended.”); *M/V Saiga (No. 2) Case*, International Tribunal for the Law of the Sea, 38 ILM 1323 (1999), at para 135 (“No evidence has been produced by Guinea to show that its essential interests were in grave and imminent peril. But, however essential Guinea’s interest in maximising its tax revenue from sale of gas oil to fishing vessels, it cannot be suggested that the only means of safeguarding the interest was to extend its customs laws to parts of the exclusive economic zone.”).

⁸⁴ See generally CRAWFORD, *supra* note 76, at 179.

⁸⁵ *Id.* See also ILC Articles, *supra* note 10, at 81.

⁸⁶ For a review of these substantive obligations, see *supra* text accompanying notes 34-40.

⁸⁷ U.S.-Argentina BIT, *supra* note 5, at Art. XI.

There are various formulations of this sort of necessity exception in different treaty instruments. GATT Article XXI(b) and (c) offer a useful site of comparison to the BIT exception:

Nothing in this Agreement shall be construed:

...

- (b) to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests
 - (i) relating to fissionable materials or the materials from which they are derived;
 - (ii) relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment;
 - (iii) taken in time of war or other emergency in international relations; or
- (c) to prevent any contracting party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.⁸⁸

There are three key points that can be drawn from a comparison between GATT Article XXI and the U.S.-Argentine BIT exception. First, the text of GATT Article XXI(b) expressly reserves authority for a signatory state to determine what “it considers necessary” for the protection of its essential security interests. There is no equivalent language within the BIT exception. This critical absence in the text makes it difficult to convincingly claim that the BIT exception is of an *entirely* self-judging or auto-interpretative nature.⁸⁹ Such a claim is especially marginal given the ruling of the ICJ on an almost identical treaty provision to that of the BIT exception in the *Nicaragua* case.⁹⁰ This is not to deny that there are serious competence concerns surrounding the capacity of an arbitral tribunal to resolve particular questions especially the scope of a state’s “essential security interests”. It appears clear

⁸⁸ GATT, *supra* note 6, at Arts. XXI(b), (c).

⁸⁹ For an extended and convincing analysis along these lines, see Alvarez & Khamsi, *supra* note 9, at 34-42.

⁹⁰ In *Nicaragua*, the ICJ examined a 1956 treaty exception in a similar form to that of Article XI of the U.S.-Argentina BIT and engaged in a comparison with GATT Article XXI:

That the Court has jurisdiction to determine whether measures taken by one of the Parties fall within such an exception, is also clear *a contrario* from the fact of the text of Article XXI of the Treaty does not employ the wording which was already to be found in Article XXI of the General Agreement on Tariffs and Trade. *This provision of GATT, contemplating exceptions to the normal implementation of the General Agreement, stipulates that the Agreement is not to be construed to prevent any contracting party from taking any action which it “considers necessary for the protection of its essential security interests”, in such fields as nuclear fission, arms, etc. The 1956 Treaty, on the contrary, speaks simply of “necessary” measures, not of those considered by a party to be such.* (emphasis added)

Nicaragua, *supra* note 62, at para 222.

though that the BIT exception contemplates *some* role for an adjudicator in the application of the treaty exception.⁹¹

There is a second useful interpretative point that can be drawn from this comparison. Unlike the BIT exception, GATT Article XXI(c) identifies the source of the obligations “for the maintenance of international peace and security” as located within the United Nations Charter. This would be a logical candidate for triggering the BIT exception even in the absence of such express wording. Under Chapter VII of the Charter, the Security Council has express authority “to maintain or restore international peace and security”.⁹² The implications of this branch of the BIT exception are often under-appreciated.⁹³ It deals with an objective that falls outside the customary arena and offers crucial textual evidence that the state parties did not simply seek to displace or incorporate custom where this would result *only* in higher standards of investment protection. The multiple branches of the exception show that they also contemplated the priority of state and even supra-national action (such as the institutional operation of Chapter VII of the U.N Charter) in defined settings.

The third key difference between the BIT exception and GATT Article XXI goes to the notion of “essential security interests”. The GATT provision limits that concept to traditional, inter-state security objectives including military and defence matters. Although the BIT exception also speaks of “essential *security* interests”, there is no indicative list of examples of that concept, leaving open the possibility that security be understood in dynamic rather than static terms. Moreover, the BIT exception offers a new ground of exemption for the “maintenance of public order” that is entirely absent from the GATT Article XXI. As with the branch of the treaty exception for “maintenance of international peace and security”, this is again important evidence of contemplation of priority of state action over and above the

⁹¹ The difficulty of accepting supra-national adjudication on these delicate questions while appreciating the need for some level of oversight is incisively touched on in the individual opinion of Judge Anzilotti in the *Oscar Chinn* case. See *Oscar Chinn*, 1934 P.C.I.J. (ser A/B) No. 61 (Dec. 12) (separate opinion of Judge Anzilotti), at 113-4.

⁹² U.N. CHARTER Art. 39. Chapter VII of the United Nations Charter sets out a series of pre-conditions to the eventual possibility of authorization of use of force by the Security Council. These include, most notably, measures not involving use of force including, “complete or partial interruption of economic relations” under Article 41. This can encompass a call by the Security Council for states to impound or otherwise restrict the assets of private nationals of the state subject to a Chapter VII process. Such an obligation would normally breach the guarantees of protection in a typical BIT. For an example of Security Council invocation of Article 41 against the Federal Republic of Yugoslavia, see U.N SC Res. 757 (1992).

⁹³ See, e.g., *Continental Award*, *supra* note 19, at para 163 and footnote 234 (characterizing this branch as “irrelevant in the context of the present arbitration”); Alvarez & Khamsi, *supra* note 9, at 301 (offering brief analysis of this branch in comparison with extended attention to notions of “public order” and “essential security interests”).

permissible limits at customary law.⁹⁴ Finally, there is the charged question of when a given measure will be “necessary” to achieve the permissible objectives listed in the BIT exception. There is no supplied test of means-end inquiry in the BIT exception, a critical departure from the secondary plea of necessity in ILC Article 25.

III. METHODOLOGY I: CONFLUENCE

There have been five arbitral tribunals that have examined Argentina’s invocation of the BIT exception. Three of these awards – *CMS*, *Enron* and *Sempra* – expressly conflate the treaty defence with the customary plea of necessity (taken to be represented by ILC Draft Article 25).

1. The Cases: *CMS*, *Enron* and *Sempra* Awards

There are subtle differences between the three tribunals in their adoption of this dominant methodology. The *CMS* Tribunal makes a show of first analysing the customary exception and then separately considering the treaty clause.⁹⁵ Yet in substance, its analysis of the constituent components of the treaty draws heavily and is largely inseparable from the customary principle. The *Sempra* Tribunal is more explicit in conflating the two standards:

This Tribunal believes...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 conditions have been defined.⁹⁶

Moreover, the *Sempra* Tribunal gives an indication of its motivation in choosing this approach. The “problem” for the Tribunal is that “the Treaty itself did not deal with the legal elements necessary for the invocation of a state of necessity... the rule governing such

⁹⁴ On the other hand, Alvarez and Khamsi seem to suggest that the inclusion of “public order” in Article XI of the U.S-Argentine BIT was intended to clarify that the customary defence of distress would apply. See Alvarez & Khamsi, *supra* note 9, at 47 and 66. Aside from the obvious naming point, their suggestion seems unlikely given that, as the ILC has documented, “cases of distress have mostly involved aircraft or ships entering State territory under stress of weather or following mechanical or navigational failure”. ILC Articles, *supra* note 10, at 78. I argue later that “public order” here is best understood as engaging the precepts underlying the concept of *ordre public*, typical in many civil law systems. See *infra* Part V(2.1).

⁹⁵ See *CMS Award*, *supra* note 54, at paras 315-352 (reviewing the state of necessity under customary international law); 353-78 (reviewing the treaty’s clauses on emergency). See also *CMS Annulment Award*, *supra* note 15, at paras. 128 (noting that the CMS Tribunal “dealt with the defense based on customary law before dealing with the defense drawn from Article XI”).

⁹⁶ *Sempra Award*, *supra* note 57, at para 376. This approach is also adopted by the *Enron* Tribunal. See *Enron Award*, *supra* note 56, at para 333.

questions will thus be found under customary law”.⁹⁷ As discussed earlier, the ILC Articles supply the operative legal test for particular elements of the customary defence, most notably for when a chosen measure will be necessary. The stringency of these operative tests is linked to the generality of operation of the customary exception. This Tribunal seems to simply crave the same sort of guidance in relation to the treaty exception, without even considering the construction and relationship between the two legal standards.⁹⁸

An initial consequence of this approach is a singular focus on the treaty exception for “essential security interests”. There is no substantive analysis of the alternate treaty ground for exemption of measures necessary to maintain “public order”, a logical if regrettable consequence of the method chosen by these tribunals. Explicit attention to the alternate treaty exemption for “public order” would raise an obvious, key difference between the customary and treaty standards at odds with the elected approach.

The method I tribunals then present what might on first view, seem to be an expansive reading of the scope of a state’s “essential security interests”. The *CMS* Tribunal for example, rejects the idea that these interests are limited to national security concerns of an international character as “there is nothing in the context of customary international law...that could on its own exclude major economic crises”.⁹⁹ Yet, the ILC Articles are soon used to significantly narrow the operation of the treaty exception. The tribunals draw on the requirement that a state safeguard an essential interest against a “grave and imminent peril” under ILC Article 25(1)(a) to find that even Argentina’s severe economic crisis would not be sufficient to fall within the treaty exception. The *CMS* Tribunal, for example, presents “a major breakdown with all its social and political implications” and “total economic and social collapse” as operative standards.¹⁰⁰ For the *Sempra* Tribunal, Argentina’s economic crisis would have had to compromise the “very existence of the State and its independence” to attract the treaty exception.¹⁰¹ Once again, it is important to clearly draw out the implications of the methodology chosen by the Tribunal. There is no textual equivalent of the ILC standard of “grave and imminent peril” in the treaty exception; these tribunals are simply importing from the customary norm an exceedingly stringent standard of operation.

⁹⁷ *Sempra Award*, *supra* note 57, at para 378.

⁹⁸ This dynamic is also at play in the deliberations of the *Enron* Tribunal. See *Enron Award*, *supra* note 56, at para 333.

⁹⁹ *CMS Award*, *supra* note 54, at para 359.

¹⁰⁰ *Id.* at paras 319-359.

¹⁰¹ *Sempra Award*, *supra* note 57, at para 348. See also *Enron Award*, *supra* note 56, at para 306.

Critically, the tribunals then draw on the ILC Articles to determine whether Argentina's chosen measures were "necessary" to protect its essential security interests. As we have seen, ILC Article 25(1)(a) requires that the means chosen must be the "only way" for the state to safeguard its interests. This highly stringent test of necessity is offered as a second ground for rejecting Argentina's defence. According to the *CMS* Tribunal, Argentina's regulatory response was not the only way to deal with the financial crisis as it possessed "a variety of alternatives, including dollarization of the economy, granting of direct subsidies to the affected population or industries and many others".¹⁰² The problem with this restrictive test is that it is almost always possible to conceive of multiple responses to a given financial crisis rendering the treaty exception largely ineffectual.¹⁰³ Again, it is important to bear in mind the reasons for such a stringent test in the customary sphere. This is a test drawn from the early precepts on the use of force in self-defence and there are good reasons to insist on such a stringent predicate in this specific context. It is highly doubtful that a state's ability to respond to financial crisis should be subject to the same restrictive form of means-end scrutiny.

There are two further uses of the ILC Articles to narrow the operation of the treaty exception. The preclusion of the customary defence where a state has "contributed to the situation of necessity" under ILC Article 25(2)(b) is introduced as an operative element of the treaty exception.¹⁰⁴ Again, there is no reflection within the treaty text of such a limiter. Argentina's contribution to the crisis is characterized rather bluntly as "substantial" and offered as yet another ground for rejecting its treaty defence.¹⁰⁵ Finally, the tribunals draw on the ILC Articles on the question of compensation where the defending state otherwise meets the operative components of the treaty exception. The confluence methodology applied to this final question is not entirely benign in the sense of the simple transport of elements of the customary plea. On this point, the tribunals arguably engage in misrepresentation of the position at customary law. This goes to the critical issue of whether a state is under a duty to compensate even if entitled to invoke a circumstance (such as the plea of necessity) to

¹⁰² *CMS Award*, *supra* note 54, at para 323. See also *Sempra Award*, *supra* note 57, at para 350-1.

¹⁰³ This is, somewhat ironically, noted by the *Enron* Tribunal: "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." (emphasis added) *Enron Award*, *supra* note 56, at para 308.

¹⁰⁴ See *Enron Award*, *supra* note 56, at para 311-2; *Sempra Award*, *supra* note 57, at paras. 311-3.

¹⁰⁵ *CMS Award*, *supra* note 54, at para 329.

preclude wrongfulness. ILC Article 27(b) is clear on this point; the otherwise successful plea of necessity is “without prejudice to *the question* of compensation for any material loss incurred by the act in question” (emphasis added).¹⁰⁶ In other words, the ILC Articles offer a reservation to the question of compensation, presenting this as a case-by-case issue to be decided between the parties concerned.¹⁰⁷ The *CMS* Tribunal though endorses Article 27 as “[establishing] the appropriate rule of international law on this issue”¹⁰⁸ but characterizes it as imposing a “*duty* to compensate” (emphasis added).¹⁰⁹

2. Problems

There are two fundamental problems with the dominant method of confluence.

2.1 *Specific: Interpretative*

The first flaw is clearly one of interpretation (and more subtly, path dependence given the sequencing and commonality of language in the *CMS*, *Enron* and *Sempra* awards). The method ignores the express taxonomy endorsed by the ILC. If we accept – as each of these tribunals do – that the ILC Articles codify custom in this area, then there is a logical obligation to follow its presented analytical structure. The ILC Articles distinctly present the customary defence of necessity as applicable to the issue of state responsibility. The elements of that defence only become operative if we have first identified a wrongful act at international law. The test for wrongfulness in turn is purely a question for the international legal regime at issue. This would involve an assessment of (i) whether there is breach of the legal obligations of the investment treaty at issue and then (ii) whether the treaty exception applies to save that breach. It is only if we have an answer of “yes” to (i) and “no” to (ii) that

¹⁰⁶ ILC Articles, *supra* note 10, Art. 27(b).

¹⁰⁷ This is made clear in the commentary to Art. 27(b): “Subparagraph (b) of article 27 is a reservation as to questions of possible compensation for damage in cases covered in chapter V” and “Subparagraph (b) does not attempt to specify in what circumstances compensation should be payable. Generally the range of possible situations covered by chapter V is such that to lay down a detailed regime for compensation is not appropriate. It will be for the State invoking a circumstance precluding wrongfulness to agree with any affected States on the possibility and extent of compensation payable in a given case.” ILC Articles, *supra* note 10, at 86 (paras. 4 and 6). This point is explicitly endorsed by the later CMS Annulment Committee. *See supra* note 15, at para 147. Argentina and its expert witness use this as a key aspect in contentions in a later arbitration. *See BG Group Plc v Argentina*, UNCITRAL Arbitration, Dec. 24, 2007 at para 398 (“Objecting to BG’s reliance on Article 27 of the ILC Draft Articles, Argentina referred to its expert witness Prof. Kingsbury, stating that the ILC Articles do not set forth that compensation should be granted in all cases where the state of necessity is alleged.”).

¹⁰⁸ *CMS Award*, *supra* note 54, at para 390.

¹⁰⁹ *Id.* at para 388.

we have a wrongful act at international law that would entitle an adjudicator to consider the customary defence. In short, the treaty and customary defences operate on different legal planes; the treaty defence comprises the set of primary legal rules that must be adjudicated upon *before* possibly attracting the secondary, customary defence. The blunt legal error in this interpretative method of confluence is especially surprising as *other* investor-state tribunals have proven themselves capable of identifying the key difference between primary and secondary rules in the ILC taxonomy.¹¹⁰

2.2 Contextual: Historical Shift from Customary to Treaty Protections

There may be some who regard this first point of criticism (and the distinction between primary-secondary planes) as excessively formalistic, a type of lawyerly trick devoid of any real substance.¹¹¹ There is though a second substantive flaw in the easy conflation of the customary and treaty standards. The method I tribunals ignore the complex and nuanced history of the shift from customary to treaty protections for foreign investors. This is a narrative that raises serious doubts as to the likelihood that the state parties would simply seek to crystallize the customary plea in the treaty exception. There are multiple factors that led state parties to build a network of investment treaties in the decades following the Second World War. The most fundamental of these – especially from the perspective of capital exporting states – was a conviction that custom was increasingly ill equipped to deal with particular challenges faced by foreign economic actors.¹¹² The result is a project of tailoring

¹¹⁰ In the recent *Biwater Gauff v Tanzania* award, the Tribunal was faced with a novel defence by the respondent state to a claim of expropriation. Tanzania had suggested that the investor's poor performance had rendered the asset in question economically worthless, quite apart from any state action. Tanzania argued in turn, as there was no economic damage there could be no act of indirect expropriation or taking. In its analysis, the Tribunal takes note of the commentary to ILC Article 2, which contemplates a similar suggestion that international responsibility may not attach to a state unless there is some "damage". The Tribunal though crucially recognizes – as affirmed in the ILC Commentary – that this is ultimately a question for the primary legal obligation in question. The Tribunal then interprets the primary, treaty obligation to conclude that economic loss or damage is not a necessary condition to the act of expropriation. See *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award, July 24, 2008, at paras 461-7. See also ILC Articles, *supra* note 10, at 36.

¹¹¹ For example, Alvarez and Khamsi suggest that: "It is also anachronistic to assume...that the negotiators of U.S. BITs (and prior FCNs with comparable NPM clauses) had, long before the ILC completed and released its Articles of State Responsibility, not only readily absorbed the implications of the ILC's distinctions between "primary" or "secondary" rules of international law but had sought to replicate these (sub silentio) in these treaties." Alvarez & Khamsi, *supra* note 9, at 47-8. Yet, as we have seen, this distinction had been in place since the appointment and work of ILC Rapporteur Ago in the early 1960s. It would be surprising if U.S BIT negotiators knew nothing of that important shift in the strategy of the ILC. This though is simple conjecture as to the subjective intent of those actors, a point at odds with my chosen method in this paper.

¹¹² Customary protections were not aimed solely at foreign investors nor were they concerned explicitly with an investor's competitive position in a host state. The customary standard was instead directed at "aliens" and

treaty standards to regulate the conduct of states vis-à-vis foreign investors, largely distinct from the position at customary international law.

To begin with, the immediate decades following the Second World War witnessed a dramatic rise in expropriation of private property by capital importing states.¹¹³ Although customary international law had devised protections for certain forms of governmental expropriation¹¹⁴, capital-importing states began to invoke justifications for newer forms of taking¹¹⁵. The most notable of these was the practice of nationalization where particular industries were targeted as part of a state-led development program. This gave rise to an open question in the period as to whether nationalization would comprise a novel category of taking distinct from the existing customary rules on expropriation.¹¹⁶ Custom, as an inherently evolutionary device, began to slowly shift in a direction favourable to capital importing states on these questions.¹¹⁷ The treaty provisions to emerge from this period counter this development and mitigate the new risk faced by foreign economic actors; nationalization along with expropriation is expressly included as a category of taking that requires full compensation by a signatory state.¹¹⁸

largely designed to counter risks specific to *individuals* present in another state. The typical complaint of the late nineteenth century in this field concerned the unlawful arrest and detention of individual aliens rather than the later strategic concern surrounding the competitive opportunities and treatment of foreign economic actors. See generally FREDERICK DUNN, *THE PROTECTION OF NATIONALS: A STUDY IN THE APPLICATION OF INTERNATIONAL LAW* 54 (1932); *Report on International Responsibility by Mr. F.V. García Amador, Special Rapporteur*, U.N. Doc A/CN.4/96 (1956), reprinted in [1956] Y.B. INT'L L. COMM'N 173, ¶ 43. See also L. OPPENHEIM, *INTERNATIONAL LAW* 376 (1905); G.G. WILSON, *HANDBOOK OF INTERNATIONAL LAW* 145 (1910) (focussing on the right to exclude and expel aliens); CC HYDE, *INTERNATIONAL LAW: CHIEFLY AS INTERPRETED AND APPLIED BY THE UNITED STATES* (1922) (addressing denial of justice and mob violence).

¹¹³ THOMAS L. BREWER & STEPHEN YOUNG, *THE MULTILATERAL INVESTMENT SYSTEM AND MULTINATIONAL ENTERPRISES* 53 (1998). Table 2.3 of this reference summarizes trends in expropriation from 1960 to 1992. The mean number of expropriations in this period were as follows: 1960-64: 11; 1965-69: 16; 1970-74: 51; 1975-79: 34; 1980-84: 3; 1985-89: 0.4 and 1990-92: 0.

¹¹⁴ *Case Concerning the Factory at Chorzów (Ger. V Pol)*, 1928 P.C.I.J. (ser. A) No. 13 (Sep. 13), at 47.

¹¹⁵ See, e.g., S.N. Guha Roy, *Is the Law of Responsibility of States for Injuries to Aliens a Part of Universal International Law?*, 55 (4) AM J. INT'L L. 863, 866-886 (1961) (detailing the attempts to characterize the law of state responsibility as an instrument of imperialism and criticizing its application to newly independent states in the post-colonial period).

¹¹⁶ See C.F. AMERASINGHE, *STATE RESPONSIBILITY FOR INJURIES TO ALIENS* 128-129 (1967) (describing nationalization as a species of expropriation but subject to special rules "differentiated from the rules relating to other cases of expropriation").

¹¹⁷ The narrative of newly independent states advancing claims to changes in customary rules on expropriation through the 1960s (including the critical General Assembly Resolution 1803) and 1970s is well known. It is important also to recognize that by the mid-1970s, a range of lump sum settlement tribunals had begun to identify some of those resolutions (particularly 1803) as reflecting "the state of customary law in the field". See *TOPCO v Libya*, 17 ILM 3, 27-31 (1974). Similar methodologies and findings were adopted in the 1983 AMINOIL award (involving the 1977 nationalization of Kuwait's oil industry) and the 1994 Ebrahimi award (of the Iran-U.S Claims Tribunal).

¹¹⁸ See generally DOLZER & SCHREUER, *supra* note 34, at 89-115.

The strategic concern as to the limitations of customary law in the contemporary period is also borne out when we consider the changes to dispute settlement processes. At customary international law, the rules on diplomatic protection entitle a state of an injured national to bring action against another state for injuries caused to that national by an internationally wrongful act.¹¹⁹ Where the injured national is an artificial legal person such as a corporation, there is the added question of whether the ability to initiate diplomatic protection is limited to the state of the corporation or may in certain situations, extend to the state of individual shareholders (where these differ). This issue arose before the ICJ in the *Barcelona Traction* case which ruled that it is only the state of incorporation of the corporate entity, rather than the state of its controlling shareholders, that can invoke a claim for diplomatic protection.¹²⁰ The modern treaty provisions again counter this gap in customary international law. They offer the possibility of direct investor to state dispute settlement and as such, are distinct from the state-to-state dynamic of customary international law. The ability to initiate this new form of dispute settlement is not limited to a foreign company that is operating in a signatory state. The typical broad, BIT definition of “investment” gives shareholders in a company the ability to bring a claim on their own behalf.¹²¹

To sum up, we have two key examples of a desire not simply to displace customary norms but to tailor the resultant treaty protections to specific concerns surrounding the entry and operation of foreign investors in host states. This is not to say that all the background elements of custom are displaced in the newer treaty instruments. Certain treaty instruments expressly link the obligation to accord fair and equitable treatment to the broader corpus of international law.¹²² This textual link evidences an intention to incorporate customary international law (on the minimum standard of treatment to be afforded to aliens) in the treaty obligation. State parties though are adopting a “pick and choose” strategy when it comes to incorporating customary law into the new treaty protections. The choice to do so appears largely an express one. Absent this express link, other treaty components (such as

¹¹⁹ International Law Commission, Draft Articles on Diplomatic Protection with Commentaries, U.N. Doc. A/61/10 (2001), Art. 1. *See also Case Concerning Ahmadou Sadio Diallo (Guinea v Congo)*, 2007 I.C.J. 103 (May 24), para 39 (Preliminary Objections).

¹²⁰ *Barcelona Traction, Light and Power Company, Limited*, 1970 I.C.J. 3 (Feb. 5), at paras. 41-47.

¹²¹ U.S.-Argentina BIT, *supra* note 5, Arts. 1(a) (definition of “investment”); VII (investor-state dispute resolution).

¹²² *See, e.g.*, U.S.-Argentina BIT, *supra* note 5, Art. II(2)(a) (“Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law.”)

expropriation and dispute settlement rules) clearly oppose customary law and offer tailored standards of operation.

With this context in mind, there are good reasons to suggest that the treaty exception *also* offers a tailored defence distinct from the customary norm. To put this differently, the process of tailoring was not only designed to offer commitments to restrain state conduct but, in certain limited circumstances, to allow for newer flexibilities on the part of the state.¹²³ First, there is no clear textual link to customary law in the treaty exception. Where state parties had intended for such a linkage to occur they had proven themselves perfectly capable of doing so expressly in *other* parts of the treaty. More fundamentally, the structure of the new treaty exception contemplates the priority of the post-war institutional structure of the Charter of the United Nations. The state parties envisioned a new ground for excuse that falls entirely outside the scope of the customary defence. Similarly, the treaty exception includes a “public order” component, which does not find direct reflection in customary law. These factors are strongly and in my view, conclusively, probative of an objective desire to expand the scope of the treaty exception over and above the customary plea. Perhaps most tellingly, the customary provision supplies an operative test for when a measure will be “necessary” while the treaty standard is silent on the choice of means-end inquiry. This precise difference between a customary and treaty standard was relied upon by the ICJ in the *Nicaragua* case in finding that the two sources of law in that case did not overlap and continued to exist alongside each other.¹²⁴

¹²³ This perspective – which I base on my method of analysis of objective factors (text, context and history) - is *also* reflected in the account of Kenneth Vandevelde, who had advised on U.S. BIT negotiations in the early to mid 1980s:

United States treaty practice since the Second World War has acknowledged that the interest in protecting United States investment overseas may be subordinate to certain other national interests, primarily the interest in protecting the national security and the health, safety and welfare of the people. Investment-related treaties thus have had provisions which permit the United States to deny protection to foreign investment in its territory where necessary to these other interests. The price paid by the United States for reserving the right to derogate from investment-related treaties on these grounds has been the recognition of a corresponding right in its treaty partners.

KENNETH VANDEVELDE, UNITED STATES INVESTMENT TREATIES, POLICY AND PRACTICE 222 (1992).

¹²⁴ In *Nicaragua*, the U.S. had argued that the provisions on use of force in the United Nations Charter had subsumed and supervened similar rules of customary international law. *See Nicaragua, supra* note 62, at paras. 173-4. The ICJ rejected this argument and found pertinent differences between the two sources of law that meant custom continued to exist alongside the treaty provision of the Charter. The Court particularly noted that the Charter provision does not regulate *all* aspects of the content of the use of force in self-defence. In particular, Article 51 of the Charter “does not contain any specific rule whereby self-defence would warrant only measures which are proportional to the armed attack and necessary to respond to it, *a rule well established in customary international law*” (emphasis added). *Nicaragua, supra* note 62, at para 176.

3. Motivations: Insights into the Sociology of Investor-State Arbitration?

Given the pointed differences between the treaty exception and the customary norm, there is the obvious question as to why the arbitrators would choose to conflate the two. This is a difficult question to answer, as the pleadings and transcript of proceedings in these cases are not publicly available. A close analysis of the awards themselves though reveals a set of intriguing clues as to the possible motivations at play in the adoption of this flawed methodology. These offer in turn crucial insight into the unique sociology of investor-state arbitration¹²⁵, a further factor which should inform our choice on other interpretative methods of reading the treaty standard vis-à-vis the customary norm.

3.1 *Argentina's Litigation Strategy: The Claim of Auto-Interpretation and its Implications*

First, there is the prospect that the preparedness of the tribunals to accept confluence may have been shaped by Argentina's litigation strategy. Argentina's defence, as revealed in the awards, places enormous emphasis on the marginal claim that the treaty exception is self-judging.¹²⁶ This is an argument that would require an adjudicator to show significant deference to the state invoking the exception. To put this slightly differently, the argument would largely exclude any appreciable role for an adjudicatory tribunal. It falls logically at an extreme end of a spectrum of the role for an external adjudicator in assessing whether the constituent elements of the treaty exception have been proven.

The risk of exclusion implicit in Argentina's case should be seen in light of the likely personal dimensions of arbitral adjudication. Appointment to an ICSID arbitral tribunal remains a prestigious, even crowning achievement for practitioners and others working in the

¹²⁵ My working (and perhaps crude) definition of sociological inquiry in this context is whether adjudicatory behaviour and normative choices are affected by social factors, specifically the ideas, identities and shared understanding of particular agents (claimants, states, arbitrators) as they interact within the system. For a fuller analysis of the use of sociological methods to examine the question of regulation of regional and bilateral trade agreements (from which I have learnt much), see Moshe Hirsch, *The Sociology of International Economic Law: Sociological Analysis of the Regulation of Regional Agreements in the World Trading System*, 19 (2) EUR. J. INT'L L. 277-299 (2008).

¹²⁶ This is clearly evident throughout the awards; see *CMS Award*, *supra* note 54, at paras. 366-373; *Enron Award*, *supra* note 56, at paras 335-9; *Sempra Award*, *supra* note 57, at paras. 279-388. The later CMS Annulment Committee appears puzzled by the insistence on litigating this marginal point. See *CMS Annulment Award*, *supra* note 15, at para 122 ("Then [the CMS Tribunal] addressed *the debate which the parties had chosen to engage in* as to whether Article XI is self-judging." (emphasis added)).

field. Once appointed, there is a natural desire to show one's professional and analytical wares, so to speak.¹²⁷ This is by no means confined to investment treaty arbitration and may even offer important systemic checks in certain settings. Consider the prevalent practice of the individual justices of the ICJ issuing separate rather than concurring judgments.

Argentina's strategy of claiming auto-interpretation would, at its most fundamental, relegate the role of arbitral members to that of bystanders in the adjudicatory process. The unappealing nature of this argument may have made the individual members of the tribunals more receptive to arguments raised by the investor at the other end of the spectrum of possible readings on the treaty exception. The investor will have logically emphasized the claim for confluence, as the restrictive conditions of the customary norm make it highly likely than the treaty exception will not apply. The tribunals are then effectively presented with a stark choice; simple deference to the state or a distinct and public role for the adjudicator in assessing defined components of the customary-treaty exception. Viewed in this light, the choice of the latter is perhaps unsurprising especially when we consider the internal and external dynamics of this system of adjudication.¹²⁸

3.2 *Dynamics of Arbitral Decision-Making*

The loose preference accorded to the customary exception may also reflect the particular dynamics of investment treaty arbitration. There are two characteristics of this system that deserve close attention. First, there is an internal dimension in that all three cases were instituted under the ICSID Convention. The ICSID rules offer a specialized forum for resolution of investment disputes, but this remains a system of arbitration with all the unique

¹²⁷ For an extended treatment of the implications of this sort of personal dimension in the shift to legalization in the WTO, see J.H.H. Weiler, *The Rule of Lawyers and the Ethos of Diplomats: Reflections on the Internal and External Legitimacy of WTO Dispute Settlement*, 35(2) J. WORLD TRADE 191, 198 (2001). See also Anne-Marie Burley & Walter Mattli, *Europe Before The Court: A Political Theory of Legal Integration*, 47 (1) INT. ORG. 41, 58-62 (1993) (examining the role of self-interest in a range of supra- and sub-national actors within the European legal system).

¹²⁸ There is of course nothing to prevent arbitrators – like domestic judges particularly in civil law systems – from conducting their own research and independently coming to a conclusion on the correctness of a particular legal position. I am grateful to Gus Van Harten for raising this point which I accept in principle but see no evidence of its application in the awards. There is, for example, no footnote citation of relevant sources other than the obvious (such as the ILC Articles) and the party submissions on the analysis of the treaty exception and its relationship to customary law. In fact, my argument here is strengthened when we compare the method I awards with the different methodology adopted by the *Continental* Tribunal. The *Continental* award is littered with footnote citation of sources separate from party submissions with a particular emphasis on WTO jurisprudence. The latter may be accounted for by the presidency of Giorgio Sacerdoti, a member of the WTO Appellate Body, on the *Continental* Tribunal.

practices, habits and language that characterize that form of adjudication.¹²⁹ At its most fundamental, arbitration is a system that prioritizes and values speed and finality over correctness in the adjudication.¹³⁰ The outcome (and its likely acceptance among the disputing parties) has traditionally been regarded as far more important than the rigour of the process of legal reasoning and justification. Second, there is a critical external dimension. ICSID rules do not provide for a standing body to adjudicate in investment disputes. Instead, a three member *ad hoc* tribunal is established with the parties each choosing a member and with a tribunal's President appointed by agreement between the parties.¹³¹ This *ad hoc* structure offers no guarantee that the arbitrators have worked together in the past or indeed, are necessarily experts in international law. This can translate into a striking, even understandable tendency to defer to "neutral" and authoritative sources such as the ILC Articles where adjudicating on an untested treaty norm.¹³² That deference can be even more pronounced when we consider that an arbitrator's behaviour may influence whether or not they are chosen for future arbitrations.¹³³ A tribunal that appears to "throw deep", offering a new unexpected reading of a treaty provision, could significantly harm its prospects in the external market for future appointments. Anchoring a reading to the respected and cited work of the ILC offers a counter to an impression of adjudicatory adventurism thereby preserving reputational credibility in the appointments market.

3. *Arbitrator Assumption as to the Telos of Subject Treaty*

Finally, and most problematically, the stringent reading implicit in the confluence methodology seems to have been chosen as representing a personal sense of the arbitrators as to how the regime should work. Here we have clear evidence from the text of the awards as revealed in this statement of the *Enron* Tribunal:

¹²⁹ See generally Philip McConaughay, *The Risks and Virtues of Lawlessness: A "Second Look" at International Commercial Arbitration*, 93 NW. U. L. REV. 453 (1999).

¹³⁰ For a thoughtful overview of this aspect of investment treaty arbitration, see DOLZER & SCHREUER, *supra* note 34, at 211-90.

¹³¹ ICSID Convention, *supra* note 40, at Art. 37(2)(b).

¹³² See Caron, *supra* note 68, at 868. This tendency is evident in the jurisprudence on other investment treaty obligations. For example, I have detailed elsewhere the striking tendency of arbitral tribunals to draw on the jurisprudence of the national treatment Article III of the GATT when adjudicating on the scope of the national treatment obligation in investment treaties. See Jürgen Kurtz, *National Treatment, Foreign Investment and Regulatory Autonomy: The Search for Protectionism or Something More?*, in NEW ASPECTS OF INTERNATIONAL INVESTMENT LAW 311-349 (Philippe Kahn & Thomas Wälde eds., 2007).

¹³³ Linda Silberman, *International Arbitration: Comments From A Critic*, 13 AM. REV. INT'L ARBN. 9, 11 (2002)

[T]he object and purpose of the Treaty is, as a general proposition, to apply in situations of economic difficulty and hardship that require the protection of the internationally guaranteed rights of its beneficiaries. To this extent, any interpretation, resulting in an escape route from the obligations defined cannot be easily reconciled with that object and purpose. Accordingly, *a restrictive interpretation of any such alternative is mandatory*. (emphasis added)¹³⁴

The order of this reasoning reveals a fundamental flaw. The *Enron* Tribunal begins by asserting its own claim as to the dominant purpose of the treaty, being one of protection of the rights of investors. This remains a key, untested assumption in the jurisprudence of investor-state arbitral tribunals.¹³⁵ The Tribunal then fashions a default, restrictive interpretative preference to comply with that claimed purpose.

This method ignores the rules and sequencing of steps on treaty interpretation at international law. Under Article 31(1) of the *Vienna Convention on the Law of Treaties*, an adjudicator must begin with the text of the treaty provision in question.¹³⁶ A given textual reading should then be considered in light of context and the object and purpose of the treaty system.¹³⁷ The primary role of the treaty text in this setting has an important disciplinary function as it prevents the adjudicator from preferencing their own intuitive sense of how the system should work over objective expressions in the treaty text.¹³⁸ The *Sempra* Tribunal subverts this order of interpretation, bypassing the text as the start-point in the interpretative process. Moreover, the stubborn claim in the jurisprudence to a dominant purpose of investment

¹³⁴ *Enron Award*, *supra* note 56, at para 331.

¹³⁵ In the *Azurix* award for example, the Tribunal ruled that:

The standards of conduct agreed by the parties to a BIT presuppose a favourable disposition towards foreign investment, in fact, a pro-active behaviour of the State to encourage and protect it. To encourage and protect investment is the purpose of the BIT. It would be incoherent with such purpose and the *expectations* created by such a document that a party to the BIT has breached the obligation only when it has acted in bad faith or its conduct can be qualified as outrageous or egregious. (emphasis added)

Azurix Corp v The Argentine Republic, ICSID Case No AB/01/12, Award (Jul. 14, 2006), para 372. *See also SGS Societe de Surveillance v Republic of the Philippines*, ICSID Case No ARB/02/6, Decision on Jurisdiction (Jan. 29, 2004), at para 116 (ruling that “[t]he BIT is a treaty for the promotion and reciprocal protection of investments...It is legitimate to resolve uncertainties in its interpretation so as to favour the protection of covered investments.”).

¹³⁶ VCLT, *supra* note 16, at art. 31(1).

¹³⁷ *Id.*

¹³⁸ For an insightful analysis of this point in the context of the shift in interpretative methods from the GATT to WTO dispute settlement systems, see Robert Howse, *Adjudicative Legitimacy and Treaty Interpretation in International Trade Law: The Early Years of the WTO, in THE EU, THE WTO AND THE NAFTA: TOWARDS A COMMON LAW OF INTERNATIONAL TRADE* 35, 51-61 (J.H.H. Weiler ed., 2000). *See also United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, Report of the Appellate Body (Oct. 12, 1998), at paras. 121-2 (where the Appellate Body criticizes the Panel for “constructing an *a priori* test” that has no basis in the text of the treaty clause at issue).

protection is itself open to legitimate contestation. On close examination, the objective expressions of purpose in the preambular recitals of a typical investment treaty reveal a concern for the interests of multiple stakeholders and values beyond an exclusive focus on the protection of foreign investors.¹³⁹ Indeed, other cases within the system have begun to adopt more rigorous approaches to treaty interpretation and have correctly identified and grappled with the multiple values referenced in the preambular recitals of investment treaties.¹⁴⁰

IV. METHODOLOGY II: THE TREATY EXCEPTION AS *LEX SPECIALIS*

As we have now seen, the dominant methodology employed in the case law conflates the status and scope of operation of the customary and treaty standards. The tribunals employing this first methodology do not, as the CMS Annulment Committee later criticizes, take a clear and rigorous position on the relationship between the two legal standards.¹⁴¹

There is another method touched upon in the jurisprudence that offers a plausible account of that relationship. This second methodology would begin from the premise that the customary standard (formalized in ILC Article 25) is a *primary* legal rule that goes to the determination of breach, operating on the same legal plane as the treaty exception. Unlike methodology I however, it offers an approach by which an adjudicator can give effect to the clear differences between the two legal standards. Method II does this by prioritising the treaty exception as an expression of *lex specialis*, constituting a specific elaboration or updating of the general customary norm.

1. *Lex Specialis* and ILC Article 55

¹³⁹ *But cf.* Alvarez & Khamisi, *supra* note 9, at 80-1 (contesting that the U.S.-Argentina BIT preambular recitals of, *inter alia*, “greater economic cooperation”, “economic development”, “effective use of economic resources” and the “well-being of workers” can be used to identify and justify a *telos* other than “protecting investors’ rights”).

¹⁴⁰ *See, e.g., Saluka Investments BV v Czech Republic*, UNCITRAL Arbitration, Partial Award (Mar. 17 2006), at paras. 296-308 (in its review of the preambular recitals of the subject investment treaty the arbitral tribunal ruled: “This is a more subtle and balanced statement of the Treaty’s aims than is sometimes appreciated. The protection of foreign investment is not the sole aim of the Treaty, but rather a necessary element alongside the overall aim of encouraging foreign investment and extending and intensifying the parties’ economic relations.”).

¹⁴¹ The CMS Annulment Committee ruled: “Those two text have 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 Article XI and Article 25 are on the same footing.” *CMS Annulment Award*, *supra* note 15, at para 131.

The *lex specialis* principle finds reflection in the ILC Articles¹⁴² and seems to be the favoured approach of a number of commentators in the field¹⁴³. For it to apply however, it is not enough that the same subject matter is covered by the treaty and customary standards. There must be some actual inconsistency, the identification of which remains a question of interpretation.¹⁴⁴ If we accept the premise of the customary standard as primary legal rule, there are key differences between the two norms especially the inclusion of the public order exception in the treaty provision. We have then the sort of inconsistency that might allow for the application of the *lex specialis* principle.

2. Scope of Priority

The identification of the treaty defence as *lex specialis* is only a start point. There is still the question of the scope of priority to be accorded to the treaty defence, a critical issue largely ignored by those sympathetic to this reading.¹⁴⁵ Here two alternative approaches may be taken, with vastly different implications for the operation of the treaty exception.

2.1 *The Residual Operation of Custom: The Oil Platforms Approach*

The first is that endorsed by the ILC Articles, which provide that the customary or general norm will continue to operate in a residual fashion.¹⁴⁶ This would see the general norm displaced *only* to the extent of any inconsistency, leaving other aspects of the general law still applicable.¹⁴⁷ The ILC Study Group on the Fragmentation of International Law presents the interpretative link in the following terms:

[T]he point of the *lex specialis* rule is to indicate which rule should be applied...[T]he special, as it were, steps in to become applicable instead of the general. Such replacement remains, however, always only partial. The more general rule remains in the background providing interpretative direction to the special one.¹⁴⁸

¹⁴² ILC Article 55 provides: “These articles do not apply where and to the extent that the condition for the existence of an internationally wrongful act or the content or implementation of the international responsibility of a State are governed by special rules of international law.” ILC Articles, *supra* note 10, at Art. 55.

¹⁴³ See, e.g., Burke-White & von Staden, *supra* note 9, at 322; McLachlan, *supra* note 9, at 390.

¹⁴⁴ CRAWFORD, *supra* note 76, at 307.

¹⁴⁵ McLachlan comes closest to addressing this issue but does so only tangentially: “Where, as here, the customary rule lays down a stricter test than the treaty language, it is unlikely that there will be a need for separate resort to custom.” McLachlan, *supra* note 9, at 390.

¹⁴⁶ ILC Articles, *supra* note 10, at Commentary paras 2-3 (p 140).

¹⁴⁷ *Id.* at Commentary para 3 (p. 140)

¹⁴⁸ ILC Fragmentation Report, *supra* note 11, at para 102.

The ICJ applied this approach in the *Oil Platforms* case¹⁴⁹ which has also found endorsement in a recent ICSID award¹⁵⁰. In *Oil Platforms*, the U.S. sought to rely on an exception for necessary “essential security interests” as a defence to Iran’s claim that U.S. military attacks on Iranian oil platforms breached the operative provisions of the treaty.¹⁵¹ Reminiscent of Argentina’s plea for auto-interpretation, the U.S. suggested that the Court should afford a “measure of discretion” to a party’s good faith application of measures to protect essential security interests.¹⁵² The ICJ rejected the idea that the treaty exception was intended to operate independently of relevant rules of international law on the use of force.¹⁵³ In particular, it applied the customary rules on self-defence to give content to the treaty standard that a given measure is “necessary” for essential security interests.¹⁵⁴ As the test for necessity in those customary rules is both “strict and objective”, it left no room for the U.S.’ proposed measure of discretion.¹⁵⁵

The *Oil Platforms* approach to the *lex specialis* principle has important implications for arbitral tribunals constituted to cases involving financial crisis. The site of inconsistency between the customary and treaty standards at issue here goes to the articulation of permissible ends. There is however a degree of overlap between the standards that cuts across this difference; both endorse “necessity” as the legal standard for when a measure should be taken to have achieved a particular end. With this overlap in mind, the stringent

¹⁴⁹ *Case Concerning Oil Platforms (Iran v U.S.A)* 2003 I.C.J. No. 90 (Nov. 6) [hereinafter *Oil Platforms*].

¹⁵⁰ See *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc v The United Mexican States*, ICSID Case No. ARB(AF)/04/05, Nov. 21, 2007, at paras 113-23 (identifying NAFTA Chapter 11 as *lex specialis* but accepting the customary international law on countermeasures as applicable in all matters not specifically addressed in Chapter 11).

¹⁵¹ The relevant part of the exception in the 1955 Treaty of Amity, Economic Relations and Consular Rights between the U.S and Iran reads:

The present Treaty shall not preclude the application of measures:

(d) necessary to fulfil the obligations of a High Contracting Party for the maintenance or restoration of international peace and security, or necessary to protect its essential security interests.

Oil Platforms, *supra* note 149, at para 32.

¹⁵² *Id.* at para 73.

¹⁵³ *Id.* at para 41.

¹⁵⁴ The pertinent part of the judgment reads:

The Court will thus examine first the application of Article XX, paragraph 1(d) of the 1955 Treaty, which in the circumstances of this case, as explained above, involves the principles of the prohibition in international law of the use of force, and the qualification to it constituted by the right of self-defence. On the basis of that provision, a party to the Treaty may be justified in taking certain measures which it considers “necessary” for the protection of its essential security interests...[I]n the present case, *the question whether the measures taken were “necessary” overlaps with the question of their validity as acts of self-defence. As the Court observed in [the Nicaragua case] the criteria of necessity and proportionality must be observed if a measure is to be qualified as self-defence.* (emphasis added)

Id. at para 43.

¹⁵⁵ *Id.* at para 73.

customary test of “necessity” – that a measure be the “only way” to effect a given end – could apply in a residual fashion to give content to the treaty provision.¹⁵⁶

2.2 *The Displacement of Custom in its Entirety: The UPS v Canada Approach*

As an alternative to the *Oil Platforms* approach, there is the possibility that the instrument of *lex specialis* could be taken to exclude the general law, in its entirety. This was the approach of the NAFTA Chapter 11 Tribunal in *UPS v Canada*.¹⁵⁷ In *UPS*, the investor had argued that particular conduct of Canada Post, a state entity created by statute with a monopoly on the delivery of certain letter mail, should be attributed to Canada using the test for attribution in ILC Articles 4 and 5. The *UPS* Tribunal rejected the idea that the ILC Articles could be used in this way and instead concluded that specific provisions elsewhere in the NAFTA – Chapter 15 that regulates the conduct of monopolies and state enterprises – constituted *lex specialis* and applied to the exclusion of the ILC Articles.¹⁵⁸ The correctness of the substantive reasoning adopted by the *UPS* Tribunal is not without question. One might expect an adjudicator to find some clear evidence of intent to fully displace the more general norm. After all, contracting out of custom should be clear and unambiguous.¹⁵⁹ The *UPS* Tribunal instead looks at an entirely separate chapter of the NAFTA and different (although at times similar) commitments to suggest that *anything* to do with attribution of state enterprises is cabined in Chapter 15. The *UPS* ruling though remains a possible (although far less convincing) approach to the scope of priority to be accorded to the special treaty norm.¹⁶⁰

¹⁵⁶ This was in fact an argument expressly made by the investor in the *Continental* award: “[The Claimant] relies also on the ILC commentary on Art. 25(1)(a) stating that the ‘plea is excluded if there are other (otherwise lawful) means available, even if they may be more costly or less convenient’ (ILC commentary para 15). This ought to be considered not only as a more precise explanation of the term ‘necessary’ with regard to the invocation of the defence of necessity under customary international law, *but also as a standard applicable in interpreting Art. XI of the BIT.*” (emphasis added). *Continental*, *supra* note 19, at para 191.

¹⁵⁷ *United Postal Service of America Inc. v Canada*, ICSID Arbitration, Award on the Merits (May 24, 2007) [hereinafter *UPS v Canada*].

¹⁵⁸ *Id.* at paras 59-62.

¹⁵⁹ ELSI, *supra* note 78. For analysis of this point within the context of the WTO dispute settlement system and its relation to the law of state responsibility, see Robert Howse & Robert W. Staiger, *United States- Anti Dumping Act of 1916 (Original Complaint by the European Communities) – Recourse to Arbitration by the United States under 22.6 of the DSU, WT/DS136/ARB, 24 February 2004: A Legal and Economic Analysis*, in THE WTO CASE LAW OF 2003 254, 276-7 (Henrik Horn & Petros Mavroidis eds., 2006).

¹⁶⁰ There may also be a specific barrier to the adoption of this reading in the text of the treaty at question. Article X of the U.S-Argentine BIT provides that: “This Treaty shall not derogate from: ..(b) international legal obligations ...that entitle investments or associated activities to treatment more favourable than that accorded by this Treaty in like situations”. U.S-Argentina BIT, *supra* note 5, at Art. X. A reading of *lex specialis* that would

3. The Puzzle of the *LG&E* Award

Our discussion so far has been relatively abstract by sketching the interpretative possibility and implications of reading the treaty exception as an expression of *lex specialis*. This method has found some reflection in the jurisprudence, albeit with some uncertainty and internal contradictions. The best candidate for a *lex specialis* approach is that of *LG&E v Argentina*, although there are intriguing hints in this direction in the *Continental* award as well¹⁶¹. Unlike the tribunals that adopt the confluence methodology, the *LG&E* Tribunal begins its analysis with the treaty exception and also finds expressly in favour of Argentina on the treaty exception (albeit within a defined time period).¹⁶² In fact, the Tribunal seems to be giving express effect to the specialized public order component of the treaty exception.¹⁶³ The analysis of the treaty provision though is not set in isolation. Much of the Tribunal's reasoning draws on customary law as it notes that "the concept of excusing a State...during what is called a 'state of necessity' or 'state of emergency' also exists in international law".¹⁶⁴ We are thus in the realm of this second methodology; although both the customary and treaty standards cover a similar subject area, the treaty provision is being applied as an expression of *lex specialis*.

We might then expect the *LG&E* Tribunal to draw on the customary standard to assess whether Argentina's chosen means were "necessary" as the only way to maintain public order or to protect essential security interests. The Tribunal though does not use the ILC Articles in this residual fashion but adopts its own rather cursory approach to "necessity". It is difficult to understand the precise test applied to assess the necessity of Argentina's chosen means. The Tribunal characterizes Argentina's response as legitimate without explaining why this is the case.¹⁶⁵

seek to displace the entire customary norm (if the customary standard offers more favourable treatment than the treaty reading) would be at odds with the constraint against derogation in this clause.

¹⁶¹ *Continental*, *supra* note 19, at para 168.

¹⁶² *LG&E Award*, *supra* note 28 at para 229.

¹⁶³ The *LG&E* Tribunal engages in an extensive if descriptive review of the consequences of the financial crisis to conclude: "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." *Id.* at paras 231-7.

¹⁶⁴ *Id.* at para 245.

¹⁶⁵ The *LG&E* Tribunal ruled:

Claimants contend that the necessity defence should not be applied here because the measures implemented by Argentina were not the only means available to respond to the crisis. The Tribunal

By adopting its own unprincipled approach to the test for “necessity”, the *LG&E* Tribunal may be simply excluding the customary standard in its entirety. In other words, the Tribunal is choosing to follow the *UPS* Tribunal’s contracting out approach rather than that of the ICJ in *Oil Platforms*. The problem though is that the *LG&E* Tribunal continues its analysis and finds, in a thoroughly unconvincing fashion, that the customary provisions would *also* excuse Argentina from liability. The strangest part of this later analysis is the summary finding that Argentina’s measure (now characterized as an “economic recovery package”) was not just legitimate (as concluded under the treaty exception) but “the only means to respond to the crisis”.¹⁶⁶

In sum, the *LG&E* award is a candidate for a *lex specialis* approach but it is not a convincing one. The problem lies in the internal contradiction of that award. If the treaty exception is an expression of *lex specialis*, then an adjudicator should determine the scope of priority to be accorded to the treaty text. This would mean either applying the customary norm in a residual fashion (where not in conflict) or displacing it entirely. The *LG&E* Tribunal appears reluctant to choose between these approaches, perhaps recognizing the strength of the former (within the internal logic of the *lex specialis* method) but also its implications (the likely preclusion of most claims to invocation). Its own poorly conceived test of “legitimacy” appears driven more by pragmatism rather than principle and will hardly aid in guiding successive tribunals in this difficult area.

V. METHODOLOGY III: SEPARATING PRIMARY AND SECONDARY APPLICATIONS

1. The Taxonomy

There is a third methodology that overcomes the deficiencies in the approaches we have considered so far. This would begin by characterizing all of the treaty provisions at issue,

rejects this assertion. Article XI refers to situations in which a State has no choice but to act. A State may have several responses at its disposal to maintain public order or protect its essential security interests. In this sense, it is recognized that Argentina’s suspension of the calculation of tariffs in U.S. dollars and the PPI adjustment of tariffs was a legitimate way of protecting its social and economic system.

Id. at para 239.

¹⁶⁶ *Id.* at para 257.

both forms of obligation and exception, as primary legal standards that determine whether a state has committed a wrongful act at international law. It is only if breach is determined by the composite application of these rules, that an adjudicator would examine the secondary possibility of the customary defence of necessity to preclude the finding of a wrongful act.

This approach finds some welcome reflection in the recent award in *Continental v Argentina*.¹⁶⁷ This follows its endorsement by the ICSID Annulment Committee that examined Argentina's claim for annulment of the *CMS* award:

[Article XI] specifies the conditions under which the Treaty may be applied, whereas [ILC] Article 25 is drafted in a negative way: it excludes the application of the state of necessity on the merits, unless certain stringent conditions are met. Moreover, *Article XI is a threshold requirement: if it applies, the substantive obligations under the Treaty do not apply*. By contrast, Article 25 is an excuse which is *only* relevant once it has been decided that there has otherwise been a breach of those substantive obligations.¹⁶⁸ (emphasis added)

This method obviously follows the preferred taxonomy of the ILC¹⁶⁹ and has echoes within the jurisprudence of the ICJ in the *Gabčíkovo-Nagymaros Project (Hungary v Slovakia)* case.¹⁷⁰

These factors aside, this method reflects a far more realistic account of the history of the emergence of investment treaty disciplines and their relationship to customary international law. For the most part, the treaty disciplines were intended to displace customary norms. The treaty project was in turn structured to offer a tailored system of legal regulation of the conduct of states vis-à-vis foreign investors distinct from the protections at customary

¹⁶⁷ *Continental Award*, *supra* note 19, at paras 166-7.

¹⁶⁸ *CMS Annulment Award*, *supra* note 15, at para 129.

¹⁶⁹ See commentary in Part II(3.2) of this paper. See also *CMS Annulment Award*, *supra* note 15, at para 134 (noting that the position that the state of necessity at customary international law is a secondary rule of international law is "the position taken by the ILC").

¹⁷⁰ This case concerned a 1977 treaty (with subsequent amendments) between Hungary and Czechoslovakia to construct a dam over the Danube river system. By the early 1990s, Hungary had suspended work on the project and as the treaty did not expressly provide for the suspension of legal obligations, Hungary argued that that customary international law offers an exception for a "state of ecological necessity" (para 40). The ICJ characterized the implications of Hungary's argument in the following terms:

The Court moreover observes that, when it invoked the state of necessity in an effort to justify that conduct, *Hungary chose to place itself from the outset within the ambit of the law of state responsibility, thereby implying that, in the absence of such a circumstance, its conduct would have been unlawful*. The state of necessity claimed by Hungary – supposing it to have been established – thus could not permit of the conclusion that, in 1989, it had acted in accordance with its obligations under the 1977 Treaty or that those obligations had ceased to be binding upon it. It would only permit the affirmation that, under the circumstances, Hungary would not incur international responsibility by acting as it did.

Case Concerning the Gabčíkovo-Nagymaros Project (Hung. v. Slov.), 1997 I.C.J. 7 (Sep. 25), para 48 (emphasis added).

international law. This method accurately tracks both the tailoring of commitment and endorses the distinct textual evidence of tailoring of flexibility in the treaty project.

This method also offers a distinct doctrinal advantage. It obliges an adjudicator to give effect to *both* the treaty exception and the customary defence, contrary to the outcome of the blunt confluence reading of method I.¹⁷¹ It thereby enables an adjudicator to avoid the temptation implicit in the *lex specialis* reading that remnants of the customary norm will simply continue to control the application of the treaty provision, rendering it all but inutile. On the other hand, there may be a criticism that method III will result in redundancy of the customary defence. The argument could run as follows: If analysis of the treaty exception occurs first and assuming its scope of operation is broader than the customary defence, then invocation of the clause will *always* preclude custom. This argument mistakes (or ignores) the different spheres of operation of these two sources of international law. Custom applies across *all* the various areas of international law. Many of these subject areas are not governed by treaties or where they are, do not have a specific preclusion clause such as Article XI of the US-Argentine BIT.¹⁷² Where a legal dispute arises in these other areas, custom remains the mechanism by which the final question of state responsibility is assessed.¹⁷³

Finally and perhaps most crucially, there is a critical normative dimension to this methodology. This is an area of international law that has become increasingly unstable as state parties exercise both “voice”¹⁷⁴ and “exit”¹⁷⁵ vis-à-vis the investment treaty regime.¹⁷⁶

¹⁷¹ The principle of effectiveness in treaty interpretation (*ut res agis valeat quam pereat*) obliges an adjudicator to give effect to all the terms of a treaty and avoid a reading that would reduce whole clauses or paragraphs of a treaty to redundancy. For expressions of this principle in the jurisprudence of the WTO, see *United States – Standards for Reformulated Gasoline*, WT/DS2/9, Report of the Appellate Body (May 20, 1996), at 23; *Japan-Taxes on Alcoholic Beverages*, WT/DS11/AB/R, Report of the Appellate Body (Oct. 4, 1996), at 10-1.

¹⁷² Even in the investment field, not all investment treaties have a preclusion clause such as Article XI of the U.S.-Argentine BIT. For example, neither of the UK-Argentine BIT nor the Australia-Argentine BIT have a preclusion clause for measures of “public order” or “essential security interests”. See Agreement Between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Argentina for the Promotion and Protection of Investments, signed Dec. 11, 1990, U.K. Doc. – Argentina No. 1, CM 1449 (1991); Agreement Between the Government of Australia and the Government of the Argentine Republic on the Promotion and Protection of Investments and Protocol, signed Aug. 23, 1995, A.T.S No. 4 (1997).

¹⁷³ For a precise example of this sort of case, see *BG Group Plc v Republic of Argentina*, UNCITRAL Arbitration, Final Award (Dec. 24, 2007), at paras. 369-398 (analysing the customary plea of necessity in the absence of a specific treaty exception in the Argentina-U.K. BIT).

¹⁷⁴ See, e.g., *Ecuador’s Notification under Article 25(4) of the ICSID Convention*, ICSID News Release (Dec. 5, 2007) (detailing Ecuador’s withdrawal of its consent to ICSID jurisdiction over disputes concerning, among others, its petroleum, gas and mineral sectors); *Bolivia Submits a Notice under Article 71 of the ICSID Convention*, ICSID News Release (May 16, 2007) (detailing Bolivia’s denunciation of the ICSID Convention).

These actions have been triggered by the enormous take-up of arbitral dispute settlement in the last ten years.¹⁷⁷ It is not just the invocation of the system that is driving these changes; the manner in which the substantive rules have been interpreted is also part of the matrix. The evolving case law has caused serious assessment among state parties as to whether the “classic” model of investment treaty, constructed in the furnace of post-Second World War contestation between developed and developing states, places too strong a constraint on regulatory autonomy. It is though enormously difficult as a matter of pragmatics and cost not only to amend the hundreds of existing bilateral instruments in operation but to do so in a manner that anticipates every possible future contingency.¹⁷⁸ Investment treaties in this respect might represent a classic embodiment of the problem of incomplete contracting in economic theory.¹⁷⁹ This raises a key role for the adjudicator to apply existing rules in such a way as to save a contract or treaty from endemic uncertainty (and to ensure continued participation/loyalty of the parties). This could involve a more sophisticated use of the customary rules of treaty interpretation to offer contextual rulings on substantive obligations (such as the fair and equitable guarantee) to better balance the interests of key stakeholders. But for hard cases – the rare but immediate occurrence of financial crisis - express clauses that directly allow for derogation and hence flexibility will be critical in the ability of the adjudicator to adopt this broader role. Method III, by divorcing the treaty exception from the stringent customary plea, offers the adjudicator an important avenue to take up this challenge.

2. Key Interpretative Issues

¹⁷⁵ A range of state parties are demanding changes to both existing and newer investment treaty rules. *See supra* text accompanying note 14 (detailing the NAFTA Free Trade Commission’s interpretation of July 31 2001). *See also infra* text accompanying note 229 (detailing changes to the U.S. Model BIT).

¹⁷⁶ On the inter-relation between concepts of “voice”, “exit” and “loyalty” in various settings, see ALBERT HIRSCHMANN, *EXIT, VOICE AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS AND STATES* (1970).

¹⁷⁷ *See* UNCTAD, *supra* note 3, at 1 (tracking exponential growth in investment treaty arbitration from 1987 to 2007).

¹⁷⁸ It is for this second factor that I am less convinced than Alvarez and Khamsi that simple amendment (“BIT parties can change the treaties that they ratify...to incorporate more sovereignty-protective provisions”) offers a comprehensive solution to the problems thrown up by the Argentine cases. Alvarez & Khamsi, *supra* note 9, at 87.

¹⁷⁹ There is remarkably little application of this aspect of economic theory to international investment treaties. One notable and insightful exception from which I have learnt much is Anne van Aaken, *Between Commitment and Flexibility: The Fragile Stability of the International Investment Protection Regime* (unpublished manuscript on file with author). *See also* ROBERT SCOTT & PAUL STEPHAN, *THE LIMITS OF LEVIATHAN: CONTRACT THEORY AND THE ENFORCEMENT OF INTERNATIONAL LAW* (2006).

The logical outcome of my preferred method III is to raise a host of difficult interpretative questions. It may have been this very prospect that drove certain arbitral tribunals to adopt the problematic but simple method of confluence. This task though cannot be avoided in applying method III; the arbitrators must engage these difficult interpretative issues without adopting external tests by rote. There are three key interpretative issues this method raises: (i) the identification and scope of “public order”; (ii) the identification and scope of a state’s “essential security interests”; and (iii) how to test when a chosen measure is “necessary” to achieve these purposes. My intent here is not to offer conclusions to these complex set of issues, which are worthy of detailed analysis in a dedicated paper. It is instead to present a first step, framework to prompt further analysis and discussion.

2.1 “Public Order” and its Adjudication in the WTO

The notion of public order as a defence or qualification to international legal rights exists in other systems of international law. For example, Article XIV(a) of the WTO General Agreement on Trade in Services enables WTO member states to take measures “necessary to protect public morals or to maintain public order”.¹⁸⁰ The GATS exception is a useful resource to draw upon for guidance on the component of an investment exception for two reasons. First, the framers of the GATS provide some general textual instruction to the scope of the public order exception in the form of footnote 5 to Article XIV(a):

The public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.¹⁸¹

This textual direction engages the requisite degree of severity of the threat. The question remains as to how one is to identify the fundamental interests of society that might trigger recourse to the public order exception. This is though a question recently adjudicated in the dispute settlement system of the WTO.

In the *Internet Gambling* case, the United States had sought to defend its domestic restrictions on Internet gambling under the GATS Article XIV(a) exception.¹⁸² Specifically, the United States argued that the practice of Internet gambling attracted elements of

¹⁸⁰ General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, in WORLD TRADE ORGANIZATION, THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS: THE LEGAL TEXTS 325, reprinted in 33 ILM 81 (1994), at Art. XIV(a).

¹⁸¹ *Id.*

¹⁸² *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/R, Report of the Panel (Nov. 10, 2004).

organized crime with resulting threats to both public order and morality.¹⁸³ Adopting a method of dynamic interpretation, the Panel accepted that there is no single meaning of notions of “public morals” and “public order” as these “can vary in time and space, depending upon a range of factors including prevailing social, cultural, ethical and religious values”.¹⁸⁴ On this basis, the Panel was prepared to accord *some* sensitivity to the applicable WTO member in defining and applying those terms according to their own systems and scales of values.¹⁸⁵ The sensitivity though was not absolute given the obligation on the Panel to give effect to those terms as a matter of treaty interpretation.¹⁸⁶

Using the well-worn path of resort to dictionary definitions in the jurisprudence of the WTO, the Panel in *Internet Gambling* eventually adopted a useful categorization of the distinct concepts of public morals and public order. Public morals were taken to denote “standards of right or wrong conduct maintained by or on behalf of a community or a nation”.¹⁸⁷ Public order in turn was seen as a distinct concept directed to the preservation of the fundamental interests of a given society, which would include the maintenance of the rule of law.¹⁸⁸ The Panel then applied this loose but workable categorization to the facts before it. A policy of restricting Internet gambling in order to prevent underage gambling and the protection of pathological gamblers would relate to public morals while the fight against organized crime would be matter of public order.¹⁸⁹

The Panel’s approach to the interpretation of “public order” reflects the origins of that juridical concept in many civil law systems. The notion of *ordre public* in French law encompasses the collection of conditions – legislative, departmental and judicial – that preserve the normal and regular functions of the state.¹⁹⁰ In short, *ordre public* is directed to the preservation of rule of law in the state concerned. The disturbance of that state of affairs though an outbreak of violence, rioting and public disorder engages directly the notion of

¹⁸³ These were identified as heightened risk of social exploitation; corruption and subversion of the democratic process; economic losses and instability and diminution of the domestic security and welfare of the United States and its peoples. *Id.* at para 3.279.

¹⁸⁴ *Id.* at para 6.461.

¹⁸⁵ The Panel ruled: “Members should be given some scope to define and apply for themselves the concepts of “public morals” and “public order” in their respective territories, according to their own systems and scales of values.” *Id.* at para 6.461.

¹⁸⁶ *Id.* at para 6.462.

¹⁸⁷ *Id.* at para 6.465.

¹⁸⁸ *Id.* at para 6.467.

¹⁸⁹ *Id.* at para 6.469.

¹⁹⁰ See Maitre J. B. Bernier, *Droit Public and Ordre Public*, 15 TRANS. OF THE GROTIUS SOC. (1929), at 84.

ordre public. Viewed in this light, certain of the key disruptive effects of the Argentine financial crisis, including incidences of widespread rioting, looting and executive instability, might fall within this conception of “public order”.¹⁹¹ This does not necessarily excuse Argentina’s liability given critical questions surrounding burden and standard of proof, temporality and the appropriate test of means-end scrutiny (all of which are considered below). We have though, as a start point, an interpretative prism to suggest that disruption that threatens the normal functioning of a state might engage “public order” concerns.

2.2 *Human Security and the Evolving Notion of “Essential Security Interests”*

A more difficult interpretative question surrounds the scope of a state’s “essential security interests” in the BIT exception. In particular, there is the charged issue of whether this concept is constrained by traditional notions of security understood as the ability of the state to counter external threats to its territorial integrity.¹⁹²

As a starting point, the text itself is not limited to “national” security interests, which tends to be the defining approach in certain other derogation clauses¹⁹³ and indeed in other parts of the BIT in question¹⁹⁴. Most of the ICSID tribunals offer perfunctory analysis before simply concluding that a state’s essential security interests could extend beyond the classic instruments of high politics to encompass financial crises.¹⁹⁵ Rather than essentially inventing an answer to this problem, an adjudicator should apply the rules on treaty interpretation to test the boundaries of this concept. Article 31(3)(c) of the *Vienna Convention on the Law of Treaties* obliges an interpreter to take into account “any relevant rules of international law applicable in the relations between the parties”.¹⁹⁶ This enables a

¹⁹¹ On this line of reasoning, see *Continental*, *supra* note 19, at para 174.

¹⁹² Perhaps unsurprisingly, this is a feature of the arguments made by investors in the Argentine cases. *Id.* at para 170.

¹⁹³ This is most evident in GATT Article XXI(b) which confines the concept of essential security interests to traditional defense or military concerns. See the quoted extracts from GATT Article XXI in *supra* Part II(3)(3.2).

¹⁹⁴ U.S.-Argentina BIT, *supra* note 5, at Art IV(3).

¹⁹⁵ For example, the *CMS* Tribunal ruled:

If the concept of essential security interests were to be limited to immediate political and national security concerns, particularly of an international character, and were to exclude other interests, for example, major economic emergencies, it could well result in an unbalanced understanding of Article XI. Such an approach would not be entirely consistent with the rules governing the interpretation of treaties.

CMS Award, *supra* note 54, at para 360.

¹⁹⁶ VCLT, *supra* note 16, at Art. 31(3)(c).

tribunal to interpret and apply an instrument in relationship to its normative environment, “other” international law.¹⁹⁷

The *Continental* Tribunal makes a step, if a little bluntly, in this direction. It draws on the Preamble of the U.N. Charter as support for the inclusion of domestic economic concerns within a state’s essential security interests.¹⁹⁸ There are however more targeted external sources that can be used to shed light on this question. In particular, the work of the U.N. Commission on Human Security focuses on the impact of financial crisis on the security concerns of states and their citizens.¹⁹⁹ That Commission argues that traditional notions of state security must be augmented by an express concern as to, what it terms, “human security”. The driver is a recognition that the contemporary state is no longer able to act as the sole purveyor of security to its people. The challenges to security are now multi-faceted and encompass events often far beyond state control, including risks of external pollution, terrorist attacks and water shortages.²⁰⁰ These changing risks require a new paradigm of “human security” not as a replacement of state security but as a complementary condition.²⁰¹ This notion of human security: “[c]omplements human development by deliberately focusing on ‘downside risks’. It recognizes the conditions that menace survival, the continuation of daily life and the dignity of human beings.”²⁰²

The Commission specifically targets financial crises as a downside risk that regularly impairs human security.²⁰³ The consequences of financial crises – shrinking output, declining incomes and rising unemployment and sharp increases in income poverty – are borne disproportionately by the most vulnerable members of the community.²⁰⁴ These adverse impacts on human security require steps not only to prevent but also to mitigate the effects of

¹⁹⁷ ILC Fragmentation Report, *supra* note 11, at para. 423.

¹⁹⁸ *Continental Award*, *supra* note 19, at para 175.

¹⁹⁹ COMMISSION ON HUMAN SECURITY, HUMAN SECURITY NOW (2003) [hereinafter Human Security Commission]. I am indebted to Rob Howse for raising the work of this Commission with me in discussions on the Argentine cases. I have also benefited greatly from the following article in understanding the potential interpretative role of the Commission’s work on human security: Robert Howse & Ruti G. Teitel, *Beyond the Divide: The Covenant on Economic, Social and Cultural Rights and the World Trade Organization*, DIALOGUE ON GLOBALIZATION: FRIEDRICH EBERT STIFTUNG No. 30 (Apr. 2007)

²⁰⁰ *Id.* at 11.

²⁰¹ This is presented in the following terms: “This understanding of human security does not replace the security of the state with the security of people. It sees the two aspects as mutually dependent. Security between states remains a necessary condition for the security of people, but national security is not sufficient to guarantee people’s security.” *Id.* at 3.

²⁰² *Id.* at 10.

²⁰³ See the extended discussion on financial crisis, *id.* at 73-90.

²⁰⁴ *Id.* at 82-3.

crises. Mitigation requires the adequate provision of social protection in the form of health care, food, shelter, water and income support.²⁰⁵ The problem though is that precisely encountered by Argentina; the ability of a state to finance social protection is at its weakest when crises compound.²⁰⁶

This analytical framework suggests that outbreaks of financial crises might engage security concerns (defined to encompass human security objectives), thereby triggering the operation of the BIT exception. There is an obvious objection to the analysis sketched so far. I began this part of the paper by searching for “relevant rules of international law” to guide an interpretation of the BIT exception. A report of a consultative body to the U.N. could hardly be said to constitute a formal source of international law. There is though a discernible link between the UN Commission’s study and the corpus of human rights conventions, especially the International Covenant on Economic, Social and Cultural Rights (ICESCR).²⁰⁷ For the Commission, there is a complementarity such that: “Human security helps identify the rights at stake in a particular situation. And human rights helps answer the question: How should human security be promoted?”²⁰⁸ The state parties of the ICESCR (including Argentina) are obliged to ensure their citizens are provided with the right to an adequate standard of living (including adequate food, clothing and housing)²⁰⁹ as well as the right to the highest attainable standard of physical and mental health²¹⁰. While state parties may progressively realize these rights²¹¹, they are under an *immediate* obligation to ensure the satisfaction of “minimum essential levels”²¹². Where the very ability of a state to meet these continuing and elementary needs of citizens is endangered through financial crises, human rights law offers a critical anchor to justify a claim to engagement of “essential security interests”.²¹³

²⁰⁵ *Id.* at 86.

²⁰⁶ *Id.* at 90. See also *Report of the High Commissioner for Human Rights: Human Rights, Trade and Investment*, U.N. Economic and Social Council, 55th Sess., Agenda Item 4, at 9, U.N. Doc. E/CN.4/Sub/2/2003/9 (2003) (finding that: “Economic instability can in turn have negative effects on the enjoyment of human rights, straining available resources in national budgets needed for the progressive realization of economic, social and cultural rights and the right to development.”).

²⁰⁷ International Covenant on Economic, Social and Cultural Rights, G.A. Res. 2200A, U.N. GAOR, 21st Sess., Supp. No. 16 at 49, U.N. Doc. A/6316 (1966), 993 U.N.T.S. 3, *entered into force* Jan. 3, 1976 [hereinafter ICESCR].

²⁰⁸ Human Security Commission *supra* note 199, at 10.

²⁰⁹ ICESCR, *supra* note 207, at Art. 11(1).

²¹⁰ *Id.* at Art. 12(1).

²¹¹ *Id.* at Art 2(1).

²¹² U.N. Committee on Economic, Social and Cultural Rights, General Comment No. 3, The Nature of State Parties Obligations, U.N. Doc. E/1991/23, para 10, 5th Sess. (Dec. 14, 1990).

²¹³ On this point, it is worth recalling the Separate Opinion of Judge Weeramantry in the *Gabčíkovo-Nagyymaró Case*: “Treaties that affect human rights cannot be applied in such a manner as to constitute a denial of human

This analysis may be criticized as suggesting a broad and overly permissive approach to the invocation of the treaty exception, with the potential for opportunistic abuse by state parties to investment treaties. It is important, however, to recall the exact stage of the analysis. So far, I have only sought to offer two distinct prisms through which to interpret the notions of “public order” and “essential security interests” under the treaty exception. This does not complete the analysis nor necessarily excuse Argentina’s liability.

There are at least three further conditions to a successful treaty defence when applied to a given fact dynamic. First, the burden of proof should rest on the invoking state (as the better informed party) to adduce objective evidence of the requisite elements of disorder and/or inability to meet key human rights obligations. That general burden though is distinct from the requisite standard of proof.²¹⁴ The latter concerns the quantity and nature of evidence necessary for a party to persuade the adjudicator of the correctness of their position and as such, to discharge its overall burden. These are not simply technical questions but instead impact on the very incentives of parties to litigate and defend particular claims. At least on the question of “essential security interests”, it would seem reasonable to require a state to justify its invocation of human rights law by offering expert validation in the form of an appropriate determination of a U.N human rights body. Second, there is an important temporal limiter. The invocation of the treaty defence should only last as long as these objective conditions allow as to do otherwise would build in a range of adverse incentives. On this critical point, the *Continental* award represents a lodestar in the jurisprudence; that Tribunal finds against Argentina on only one measure (a debt swap) and does so because of its imposition in 2004 “when Argentina’s financial conditions were evolving towards normality”.²¹⁵ Finally and most importantly, there is the overarching test for determining whether the state’s actual measures were “necessary” to the achievement of those objectives. It is in this part of the inquiry that an adjudicator has a critical role to play in checking for abuse of the invocation of the exception.

rights as understood at the time of their application.” *Case Concerning the Gabčíkovo-Nagymaros Project (Hung. v. Slov.)*, 1997 I.C.J. 7 (Sep. 25), at 114 (Separate Opinion of Judge Weeramantry).

²¹⁴ On this critical distinction, see *Oil Platforms*, *supra* note 149, at para 33 (Separate Opinion of Judge Higgins). For an extended and careful analysis of these separate concepts within the law of the WTO, see also Henrik Horn & Joseph Weiler, *European Communities – Trade Description of Sardines: Textualism and its Discontent*, in *THE WTO CASE LAW OF 2002* (Henrik Horn & Petros Mavroidis eds., 2005), at 261-73.

²¹⁵ *Continental*, *supra* note 19, at para 221-2.

2.3 Necessity:

Proportionality Review versus a Reasonable Less Restrictive Means Test

The necessity component of the treaty exception asks a question of the closeness or fit between the chosen means and the asserted regulatory purpose of the state in question. There are though various methods of engaging in means-end inquiry. It is possible to discount one candidate at the outset; the customary test that the chosen measure be the “only way” for the state to achieve its asserted goal. Given that the treaty exception under our preferred methodology III acts as a primary norm, there is no obligation on an adjudicator to adopt this exceedingly stringent secondary test.

In a recent paper, William Burke-White and Andreas von Staden offer another possible method of means-end inquiry. Drawing on the margin of appreciation doctrine in the jurisprudence of the European Court of Human Rights, the authors suggest:

[The European Court of Human Rights] will, in a first step, review whether the impugned measure can be characterized as pursuing such a legitimate objective. In doing so, the court assesses the measure in an abstract way and will accept the domestic legislature’s “judgment of what is ‘in the public interest’ unless that judgment be manifestly without reasonable foundation.” The result, then, is a “wide margin of appreciation”. In a second step, however, the Court will inquiry whether the operation measures chosen to achieve the legitimate objective in question meet a “fair balance” test: that test is failed if the individual claimant, in light of the objective pursued has to bear an “excessive” or “disproportionate” burden... The transfer of such a two-stage review process to BIT NPM clauses would be straightforward: In the first step, an arbitral tribunal would determine whether a measure’s purposes falls reasonably within one of the permissible objectives, with the invoking state being granted an appropriate margin. *If the purpose is legitimate, then the tribunal would in a second step weight the public interest pursued against the burden imposed on the foreign investor and determine whether the latter were proportional.*²¹⁶ (footnotes omitted, emphasis added)

My analysis shares some commonality with parts of the Burke-White and von Staden thesis. I have argued that an adjudicator should exhibit institutional sensitivity on the question of the engagement of permissible objectives in the treaty exception. This might be in relation to the respondent state (say on disruption to “public order”) but it could also engage the competence of an expert human rights body (especially on a human security understanding of “essential security interests”). However, I depart from those authors in their endorsement of the

²¹⁶ William Burke-White & Andreas von Staden, *Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures in Bilateral Investment Treaties*, UNIV. OF PENN. LAW SCHOOL WORKING PAPER NO. 152 (2007), at 49-50.

“second step”. They are suggesting a form of proportionality review in testing whether a chosen measure is “necessary” for the asserted regulatory objective.²¹⁷

Proportionality review requires an adjudicator to determine whether the costs imposed by the measure are excessive or disproportionate to the benefits of the policy objective. The inquiry focuses on the regulatory objective itself. This can be abandoned depending on the adjudicator’s own assessment of the regulatory objective against attendant costs.²¹⁸ It is important to note the institutional choices inherent in an approach based on proportionality review. The judicial organ becomes responsible for assessment of relative values (and their weighting) rather than national legislatures. Yet, this form of weighting often involves complex value-laden and empirical judgments. It is highly doubtful that courts, in general, are better assessors of values and empirical questions than elected representatives.²¹⁹

Lawyers are better positioned to adjudge deficiencies in process rather than such complex decisions.²²⁰

²¹⁷ For another endorsement of proportionality review in this field, see August Reinisch, *Necessity in International Investment Arbitration – An Unnecessary Split of Opinions in Recent ICSID Cases?*, 8 J. WORLD INV. & TRADE 191, 201 (2007) (arguing that a more appropriate approach in cases involving financial crises “would probably have to incorporate considerations of adequacy and proportionality”). See also *Oil Platforms*, *supra* note 149, at para 33 (Separate Opinion of Judge Higgins) (suggesting that ‘in general international law, “necessary” is understood also as incorporating a need for “proportionality”’).

²¹⁸ For an excellent analysis of this aspect of proportionality review (termed as cost-benefit balancing by the author) and whether that test finds reflection in the law of the WTO, see Donald Regan, *The Meaning of ‘Necessary’ in GATT Article XX and GATS Article XIV: The Myth of Cost-Benefit Balancing*, 6 (3) WORLD TRADE REV. 1-23 (2007). See also Federico Ortino, *From “Non-Discrimination” to “Reasonableness”: A Paradigm Shift in International Economic Law* (Jean Monnet Working Paper No. 01/05, Apr. 2005). This delicate dimension of proportionality review has also been raised in an *amicus curiae* submission in an ICSID case concerning the impact of Argentina’s post-crisis measures on the rights of a foreign water concessionaire. See *Amicus Curiae Submission* (Centro de Estudios Legales y Sociales, et. al.), *Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A v Argentina*, ICSID Case No. ARB/03/19 (Apr. 4, 2007), 25 (on file with author).

²¹⁹ This point is nicely captured by Eric Stein and Terrance Sandalow:

An informed balancing process will often require complex technological data and elaborate market analyses. In the United States, the data gathering takes place before the trial court, state or federal, since no new facts are admissible on appeal. In the absence of an institutional mechanism for informing the court systematically of the ‘legislative facts’, the burden is upon the parties to do so. The limited resources of one or both of the parties or their limited stake in the litigation will often affect the adequacy of the record developed by them. Thus in the Oregon non-returnable bottle litigation, the plaintiff attacking the state law was a well-endowed national trade association representing the entire industry concerned, while the state had to rely on its miniscule legal staff and a volunteer academic expert. In such uneven contests, the balance may at times be redressed by the appearance of interest groups as interveners or ‘friends of the Court’. On the whole, however, it may fairly be said that American courts have not adequately solved the problem of informing themselves regarding the complex determinations which are necessitated by the balancing process required by contemporary Commerce Clause doctrine. Although the courts generally have the authority to appoint impartial experts and charge the costs to the parties, they do not commonly do so.

Eric Stein & Terrance Sandalow, *On the Two Systems: An Overview*, in *COURTS AND FREE MARKETS: PERSPECTIVES FROM THE UNITED STATES AND EUROPE* 29-30 (Terrance Sandalow & Eric Stein eds., 1982).

²²⁰ JOHN HART ELY, *DEMOCRACY AND DISTRUST: A THEORY OF JUDICIAL REVIEW* 102 (1980).

It is true that proportionality review has found reflection in the jurisprudence of various European courts. It is though important to bear in mind the imperatives that have driven that choice in the European context and as such, the limited justifications for a transplant to the investment treaty context. Miguel Maduro has argued that this doctrinal approach to Article 30 of the EC Treaty has been carefully chosen as part of a broader normative project. Maduro has presented the increased judicial activism of the European Court of Justice in applying this test as reflecting a normative goal of positive integration or “market building” in the European context.²²¹ The Court’s increased judicial activism is in turn a response to the failure of the legislative arms of the European political process to implement this broader goal.²²²

The choice then of this test in part of the European *acquis* is explicable due to very specific factors; the existence of a normative goal (positive integration) and an institutional malfunction (the failure of the European legislative process to implement that goal). Needless to say, neither of these directives is even remotely present in the loose network of international investment treaties. Moreover, it is important to bear in mind the broader implications of the form of dispute settlement that characterize this area of international law. There is no appellate mechanism that – properly constructed – might operate to discipline unprincipled instances of first instance judicial activism under a proportionality test. This is a critical constraining factor given, as we have seen, the particular sociology of investor-state arbitration (and especially its intuitive claim to an exclusive *telos* of investment protection).

There is an alternate approach that might offer a more appropriate role for *ad hoc* arbitral tribunals in testing the “necessity” of an impugned measure. This would be a form of “less restrictive means” (LRM) analysis. LRM analysis offers a key advantage over proportionality review. In an LRM test, the adjudicator does not pass judgment on the relative importance of the goal chosen by the invoking state. Her inquiry focuses only on: (i) whether there is an alternative measure available to the state that achieves the *same* level of benefit as the chosen measure, where (ii) the alternative measure results in less restrictive effects on foreign investment. Where such an alternative exists, then the state’s chosen

²²¹ MIGUEL MADURO, WE THE COURT, THE ECJ AND THE EUROPEAN ECONOMIC CONSTITUTION – A CRITICAL READING OF ARTICLE 30 OF THE EC TREATY 88 (1998).

²²² *Id.* at 98.

measure will not be “necessary” and the state may not rely on the treaty defence. It is important to note that an alternative measure will only be assessed under this test if it achieves the *same* level of benefit as the chosen measure. There is then no possibility that the adjudicator can substitute her own judgment to that of the state in the appropriate level of benefit to flow from the chosen measure. Of all the various cases constituted to date, it is only the *Continental* Tribunal that evinces a sophisticated understanding of the more modest role implicit in an LRM test.²²³

There are though legitimate criticisms of the LRM test that still require serious consideration. The most fundamental goes to the issue of how an adjudicator is to treat the cost of the alternative measure vis-à-vis the chosen measure. The *CMS* Tribunal for example, identified a variety of alternatives to Argentina’s chosen measure, including “the granting of direct subsidies to the affected population”.²²⁴ In a simple LRM test, the adjudicator would look to whether the alternative measure (subsidization of consumers of utility services) achieves the same level of benefit at a less restriction to foreign investment than the chosen measure (abrogation of investor rights under utility contracts). The logical outcome of this analysis is that the state would always be required to bear the costs of the alternate, less restrictive option (of subsidization of utility services). On this hypothetical at least, the significant costs of subsidization would make this a highly tenuous, speculative alternative given likely real world, budgetary constraints on the part of an invoking state.

There is though another possible version of LRM analysis that offers a more sophisticated treatment of the differential costs of opposing alternatives. Such an approach would not only identify a less restrictive alternative but assess whether it is a *reasonable* alternative given the different costs involved. To be precise, the state’s chosen measure will be necessary if every alternative measure achieves the same level of benefit at less restriction but involves

²²³ There are two key extracts from the *Continental* award in this respect:

“The Tribunal will look ...to alternatives to the Measures, not in breach of the BIT, that might have been reasonably available when the Measures challenged were taken (thus from November 2001 onwards) and *that would have yielded equivalent results/relief...*” (emphasis added)

“In evaluating whether these alternatives were in fact reasonably available and would have avoided the adoption of the challenged Measures, 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 choices available, in order to protect its essential interests at the time, than to adopt these Measures.” (emphasis added)

Continental Award, *supra* note 19, at paras 198-9.

²²⁴ *CMS Award*, *supra* note 54, at para 323.

unreasonable administration and enforcement costs. Under this reasonable LRM test, a tribunal could then evaluate the cost and time delays that would be incurred by a state in adopting the alternate course of action. The notion of a reasonable LRM test is not without precedent and has found reflection in the case-law of the WTO.²²⁵

A reader at this stage may wonder whether a reasonable LRM test collapses into the form of proportionality review criticized earlier.²²⁶ It is true that a reasonable LRM test involves some form of balancing. The type of balancing is though very different to full-blown proportionality review. In the latter, the adjudicator *directly* balances the benefit of the goal as against the restriction to foreign investment. In contrast, the reasonable LRM test does not at any point authorize an adjudicator to judge the relative importance and benefit of the goal. She is only entitled to balance the different enforcement cost with the restriction on foreign investment.

There may be some who regard the reasonable LRM test as too deferential to a regulating host state. This seems a misplaced concern as we have only assessed the test against one somewhat extreme example; whether subsidization of consumers might constitute a reasonable less restrictive alternative to Argentina's chosen measure of abrogation of the contractual rights of foreign investors operating utility concerns. The idea that the full costs of responding to the escalating costs should be borne entirely by the state and by extension, its citizens seems an unreasonable outcome especially given the absence of any evidence of discrimination directed at foreign economic actors. On the other hand, there are other possibilities that might constitute reasonable less restrictive alternatives to simple abrogation of investor rights.

One possibility was raised in passing in the *LG&E* award. The *LG&E* Tribunal noted that Argentina's measure – suspension of contractual rights of foreign investors – was applied

²²⁵ See, e.g., *Korea-Beef*, *supra* note 82, at para 166. There is a regrettable perception among commentators that the WTO Appellate Body's ruling in *Korea-Beef* endorses direct proportionality review. For an extended critique of this claim and insightful argument that the case turns on a reasonable LRM test, see Regan *supra* note 218. See also see MICHAEL J. TREBILCOCK & ROBERT HOWSE, *THE REGULATION OF INTERNATIONAL TRADE* 517-8 (3rd ed., 2005) (endorsing reasonable LRM analysis generally in the context of the environmental exceptions in GATT Articles XX(b) and (g)).

²²⁶ This is by no means an unlikely occurrence. There are parts of the *Continental* award (that on the whole endorses a reasonable LRM test) that veer towards full blown proportionality review. Take for example the strange election of that Tribunal (given its otherwise disciplined analytical structure) to assess "whether Argentina could have adopted at some earlier time different policies, that would have avoided or prevented the situation that brought about the adoption of the measures challenged". *Continental*, *supra* note 19, at para 198.

“across the board” rather than through individual assessment of particular utility contracts.²²⁷ Individual assessment would presumably entail the assessment of whether rights under a particular utility contract should be abrogated given their likely contribution to the continuation and scope of the crisis. A contractual right that would entitle a foreign investor to increase the tariff rate for electricity or gas supply might be treated differently to a contract involving the provision of telecommunications services. There could be a good case for abrogation of the former but retention of the latter. In this case, individual assessment is clearly a less restrictive alternative to the “across the board” measure; it offers review of each case on its own merits and the possibility that some public utility contracts may escape abrogation of rights. Moreover, the enforcement cost of an alternative such as this is clearly far less than the extreme option of direct subsidization. This is not to say that individual assessment is necessarily a reasonable LRM. There may still be a convincing argument that the time implicit in setting up a system such as this would prevent Argentina from offering an immediate response to the escalation of the financial crisis. That aside, this opposing hypothetical offers a useful indication of how the reasonable LRM test might be sensibly applied by future adjudicators to carefully balance the interests of both foreign investors and an invoking state.

VI CONCLUSION

The conflicting jurisprudence to emerge from the Argentine cases on the scope of the treaty defence has already prompted a shift in treaty practice. Newer investment instruments, especially those concluded by the U.S, have been amended to ensure the invocation of the treaty exception becomes a matter of competence for signatory states alone.²²⁸ The shift towards auto-interpretation in this area is however only a prospective one. There remain

²²⁷ *LG&E Award*, *supra* note 28, at para 241.

²²⁸ It is notable that the 2004 revisions to the Model U.S BIT adopts language indicating auto-interpretation on the question of a state’s “essential security interests” while removing the public order component of the defence. See 2004 U.S. Model BIT, art. 13, *available at* http://www.ustr.gov/Trade_Sectors/Investment/Model_BIT/Section_Index.html. The 2006 Peru-U.S Free Trade Agreement incorporates this provision in Article 22.2 with an added gloss further pointing towards auto-interpretation. Footnote two provides: “For greater certainty, if a Party invokes Article 22.2 in an arbitral proceeding initiated under Chapter Ten (Investment) or Chapter Twenty-One (Dispute Settlement), the tribunal or panel hearing the matter shall find that the exception applies.” Peru-U.S Free Trade Agreement, *signed* Apr. 12, 2006 *available at* http://www.ustr.gov/Trade_Agreements/Bilateral/Peru_TPA/Final_Texts/Section_Index.html.

dozens of pending cases where adjudicators will be required to interpret and apply the operative components of the treaty defence

In their deliberations, these tribunals should carefully consider and test the relationship between the treaty defence and the customary plea of necessity. The dominant methodology in the jurisprudence to date of conflating these two legal standards fails to engage this fundamental question. Those tribunals simply assume that the treaty exception and the customary defence are one and the same. This is mistaken both on a close interpretation of the two legal standards and on a broader historical analysis of the emergence of investment treaty norms. Given the substantive flaws in the easy conflation of the customary and treaty standards, there is an open question as to why tribunals to date would engage this questionable methodology. I have attempted to isolate the sociological features may have been at play in this method through a close reading of the awards. These reveal continuing tensions in the field of international investment law, not least the problematic suggestion that the single value of protection should exclusively inform our understanding of the purpose of investment treaties.

The choice for future adjudicators, to my mind, really comes down to an election between methods II and III. The *LG&E* award reveals a flirtation with the precepts of reading the treaty defence as an expression of *lex specialis*. It fails though to engage the fundamental question surrounding that methodology II, which is the scope of priority to be accorded to the treaty defence. There is a plausible claim that custom continues to operate in a residual fashion unless in direct conflict with the specialized treaty defence. This approach would justify an adjudicator applying the strict customary necessity test of means-end inquiry to the treaty exception. The practical outcome of this would be a type of method I redux, the preclusion of the defence in all but the most extreme situations.

Methodology III is by far the most convincing and coherent reading of the relationship between the two legal norms. It reflects the precise taxonomy adopted by the ILC in its formulation of Article 25 and ensures that both legal standards are given full effect. Method III would see the treaty defence adjudicated as a primary legal standard going to the question of whether there is a wrongful act at international law. This is a predicate to the application of the secondary customary rules that allow for the plea of necessity. In highly exceptional

circumstances, that customary plea will preclude wrongfulness as a matter of state responsibility.

The favoured method III of this paper obliges an adjudicator to interpret the treaty defence on its own terms without simply transplanting from customary law. This is by no means an easy task and raises a series of fundamental interpretative choices and challenges. I have attempted to present the beginnings of an interpretative framework to guide that task. In my view, the effects associated with financial crisis (and especially in the case of the Argentine crisis) are sufficient to engage both notions of “public order” and “essential security interests”. That analysis though only goes to the scope and engagement of the permitted regulatory objectives of the treaty defence. Many of these cases will and should turn on the critical issue of how an adjudicator assesses the “necessity” of the actual measures implemented by a regulating state to mitigate the effects of such crises. The question of “necessity” concerns the closeness or fit between the chosen means and the permitted regulatory objectives. On this question, I depart from the prevailing enthusiasm in the literature on variants of proportionality review. This method authorizes an adjudicator to directly assess the value and empirical justification of a regulatory objective. There may be strong systemic reasons for such an activist test in certain domestic and supra-national settings (such as the European Union). Those reasons are entirely absent in the loose and at times, unprincipled, system of adjudication in the network of international investment treaties. A test of reasonable less restrictive means analysis is a more appropriate one for this system of adjudication. Properly formulated and applied, such a test offers key stakeholders in the system – including foreign investors themselves – crucial assurance against the legitimate concern of the opportunistic invocation of this exception.