INVESTMENT TREATIES AND PUBLIC GOODS

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An important difference between international trade law and international investment law is the presence in the former, but not usually in the latter, of general exception provisions to facilitate the member state pursuing certain domestic policies. This is not merely a technical distinction, but reflects the different philosophical basis of the GATT/WTO regime of 'embedded liberalism' as opposed to the 'laissez-faire liberalism' of most bilateral investment treaties. This presentation examines how investment treaty tribunals have dealt with conflicts between investor rights and regulatory autonomy in the absence of general exception language. It suggests that the absence of express text recognising and delimiting the circumstances in which host states may derogate from investor protections to provide public goods has contributed to inconsistent, tenuous and unpersuasive reasoning. Tribunals should not be forced to create the law in this area. Instead, public goods, as an integral part of the political economy of host states, should be expressly referenced in modern investment instruments. Moreover, future revisions to bilateral investment treaties should be made in the context of a wider re-examination of their purpose and how they link with a wider development agenda.

I. Introduction

It is a truism that multinational business operates in a global environment. In getting products to market, firms move seamlessly between importing and exporting goods, providing cross-border services and making use of an international production and distribution network. All of these activities form part of a single commercial operation.

It is, therefore, an interesting quirk of legal history that the international economic law which regulates these activities is divided along the tenuous boundary of trade and investment. Although the practical difference between trade in services through commercial presence and FDI investment may be slight, the regulatory disparity remains significant. This is not merely a distinction between WTO and BIT regulation. It is a distinction discernible in most, if not all, FTAs which include both trade and investment chapters.

There are a number of well-understood differences between the two regimes. In this presentation, I want to focus on one particular difference: the absence, for the most part, in BITs of broad general exception provisions such as those found in the WTO system.

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This is not a technical issue, but an issue of basic concept – how best to balance investor rights against state police powers. It has been highlighted, albeit indirectly, by the swathe of investment treaty cases taken against Argentina. It has been given renewed emphasis by the possibility of action against developed countries for their own responses to the global financial crisis.[1] And it is worth particular attention because it has been marginalised in recent years by the more vocal debate over whether the investment treaty system lacks transparency, legitimacy or is simply biased towards investors.

The wider legitimacy debate is both interesting and important. Gus Van Harten's thesis that investment arbitration is really a species of international administrative law raises serious systemic questions.[2] Susan Francke has recently progressed the debate by reference to evidence that developing countries are not statistically disadvantaged by investment treaty arbitration.[3] But even if this is so, it tells us that international investment law as written is applied neutrally and fairly. It does not confirm that international investment law is itself neutral and fair.

It is surprisingly easy to conflate the two propositions. Indeed, someone as clear-sighted as Jan Paulsson wrote over twenty years ago that developing countries should recognize 'international [investment] arbitration as it is: a neutral means for the resolution of conflicts... to be mastered rather than complained about'.[4] Such advice puts me in mind of Anatole France's dry observation that '[t]he law, in its majestic equality, forbids rich and poor alike to sleep under bridges, to beg in the streets, and to steal their bread'.[5] As a leading international politics text points out: '[r]ules shore up power not just because they are biased or enforced unequally...but by singling out for prohibition or restriction the strategies available to some actors and not the strategies available to others.... The rules themselves are therefore a major focus of contention'.[6]

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1 See, eg, A Van Aaken & J Kurtz 'The Global Financial Crisis: Will State Emergency Measures Trigger International Investment Disputes' *Colum FDI Perspectives* (23 March 2003).

2 See G Van Harten *Investment Treaty Arbitration and Public Law* (New York: OUP, 2007) and G Van Harten & M Loughlin 'Investment Treaty Arbitration as a Species of Global Administrative Law' (2006) 17 *Eur J Int'l L* 121, 121-23.

3 S Franck 'Development and Outcomes of Investment Treaty Arbitration' (2009) 50(2) *Harv Int'l L J* 201.

4 J Paulsson 'Third World Participation in International Investment Arbitration' (1987) 2 *ICSID Rev Foreign Inv L J* 19, 20.

5 Anatole France *Le Lys Rouge* (1894, tr The Red Lily, 1908) ch VII.

6 T Janoski, R Alford, A Hicks, and M Schwartz *The Handbook of Political Sociology: States, Civil Societies and Globalization* (Cambridge: CUP, 2005) 46.

Few would contend that BITs have traditionally reflected a balanced deal. As José Alvarez has recently written, '[i]n the early days of the U.S. BIT program, the treaty's references to "reciprocal" investment flows was something of a fraud'.[7] The majestic equality of US-Mongolia BIT, for instance, permits Mongolian investors to the US the same legal protections as American investors to Mongolia. Indeed, as Alvarez himself candidly remarked in 1992:[8]

> A BIT negotiation [with the US] is not a discussion between sovereign equals. It is more like an intensive training seminar conducted by the United States, on U.S. terms, on what it would take to comply with the U.S. draft. The result is an instrument that it not by any means balanced as between the rights and responsibilities of multinational corporations.

We all know the situation is changing. Canada has habitually included general exception provisions in its BITs, the US's 2004 Model BIT seeks to strike a different balance between investor rights and state regulatory autonomy from the 1994 version[9] and China's first FTA, with New Zealand, specifically incorporates a general exception modelled on GATT Article XX. We also know, from Burke-White and Von Staden's study of non-precluded measures clauses in BITs[10] that there is some scope, particularly in BITs with the US and Germany, for invoking these clauses to protect state interests. But most BITs do not contain any form of exception or non-precluded measures clause,[11] and those which do are usually drafted more narrowly and for a more limited purpose than their GATT equivalents.

There is, as yet, no clear consensus as to whether recent moves to 'rebalance' the international investment regime are for the better or will have lasting effect.

The purpose of this presentation is to make three suggestions.

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7 J Alvarez 'The Evolving BIT' *Transnat'l Dispute Manag't*, http://www.transnational-dispute-management.com (3 June 2009) 3.

8 See Alvarez, above n 7, 4. In another article, Professor Alvarez has tentatively remarked that one might see in BITs some aspects of contracts of adhesion: J Alvarez & K Khamsi 'The Argentine Crisis and Foreign Investors' in K Sauvant (ed) *Yearbook on International Investment Law and Policy 2008-2009* (New York: OUP, 2009) 473.

9 See K Vandevalde 'A Comparison of the 2004 and 1994 U.S. Model BITs: Rebalancing Investor and Host Country Interests' in K Sauvant (ed) *Yearbook*, above n 8, 283.

10 W Burke-White & A Von Staden 'Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties' (2008) 48(2) *Va Jn'l Int'l L* 307.

11 A Newcombe & L Paradell *Law and Practice of Investment Treaties* (The Netherlands: Wolters Kluwer, 2009) 488 fn 29; and C Brower II 'Obstacles and Pathways to Consideration of the Public Interest in Investment Treaty Disputes', in K Sauvant (ed) *Yearbook*, above n 8, 347, 372 fn 116.

First, what international investment law needs above all else is treaty text which expressly grapples with the hard questions. The absence of adequate treaty language in older BITs has led to tribunal reasoning which, whilst well-meaning, is unanchored and unconvincing. In the long run, this can only erode the credibility and legitimacy of the emerging system.

Secondly, we must continue the wider debate as to the proper objectives of BITs and the linkages between investment law and other areas. It is obviously easier to draft appropriate treaty language onto a firm jurisprudential foundation.

Thirdly, although agreement as to whether BITs should be simple instruments of investor protection,[12] or linked to broader issues of development,[13] is not likely to be reached soon, this is no excuse for new BIT language to avoid reference to public goods. Even without untying the Gordian knot which proved fatal to the 1998 MAI, and in June 2009 put paid to Norway's progressive Draft Model BIT,[14] it should still be possible to create an express and circumscribed allowance in BITs for the provision by states of public goods. Especially when the alternative is tribunals crafting their own solutions through exegesis.

In these respects, I believe the investment treaty regime has something to learn from the more mature GATT/WTO regime. In what follows, I ask four – admittedly basic – questions. For these, I beg the indulgence of this sophisticated audience:

(1) what is the rationale for the general exception provisions in international trade law?

(2) what is the rationale for the typical absence of general exception provisions in international investment law?

(3) is international investment law able to strike the right balance between enforcement of investor rights and state regulatory power in the absence of general exception provisions?

(4) what implications might follow from the answers to the above questions?

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12 S Schwebel 'The United States 2004 Model Bilateral Investment Treaty: An Exercise in the Regressive Development of International Law' (2006) 3(2) *Transnat'l Dispute Manag't*, http://www.transnational-dispute-management.com; and K Vandevalde "The Political Economy of a Bilateral Investment Treaty" (1998) 92 *Am J Int'l L* 621.

13 See P Muchlinski 'Trends in International Investment Agreements: Balancing Investor Rights and the Right to Regulate. The Issue of National Security' in K Sauvant (ed) *Yearbook*, above n 8, 35 and 48.

14 D Vis-Dunbar 'Norway Shelves its Draft Model Bilateral Investment Treaty', *Investment Treaty News*, www.investmenttreatynews.org (8 June 2009).

II. Public Goods

First, however, I should say a few short words about public goods in economic theory.

The distinction between private and public goods goes back to Adam Smith's *An Enquiry into the Nature and Causes of The Wealth of Nations*, in which Smith recognised that – powerful though the market was, it did not create incentives to create 'public institutions and public works [even] though they may be in the highest degree advantageous to a great society'.[15] Our modern understanding of public goods comes from economist Paul Samuelson, who in 1954 defined public goods as those which are non-rival (ie, the use by X does not preclude the opportunity of use by Y) and non-excludable (ie, it is impossible or impracticable to limit use of the good to X).[16] It is easy enough to think of goods which manifestly (though not absolutely) bear these qualities. Numerous intangible social benefits come to mind, such as clean air and potable water, national defence, law enforcement and a stable political and financial system. Tangible examples also exist, such as lighthouses,[17] public highways and streetlights.

It is recognised that adequate provision of public goods usually requires non-market mechanisms, such as public budgets and taxes;[18] and that, in practice, solutions are identified not by technical analysis but mediated through the vicissitudes of domestic politics.[19] As many have pointed out, globalisation has added a new layer of complexity to this process. For the purposes of this paper, I make the simple claim that public goods are a critical part of a state's political economy. International economic instruments should therefore be – and be seen to be – compatible with the adequate provision of public goods.

III. The General Exception Provisions in WTO Law

The issue of combining economic liberalisation with the adequate provision of public goods has been addressed carefully – though inevitably imperfectly – by the WTO system. In simple terms, the WTO represents an explicit compromise between trade liberalisation and regulatory autonomy. In the more nuanced terms of John Ruggie, the 1947 GATT –

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15 A Smith *An Enquiry into the Nature and Causes of The Wealth of Nations* (London: Methven & Co, 1776), Vol 1, 69.

16 P Samuelson 'The Pure Theory of Public Expenditure' (1954) 36(4) *Rev of Econ and Statistics* 387.

17 R Coase 'The Lighthouse in Economics' (1974) 17 (2) *J Law and Econ* 357.

18 R Musgrave & P Musgrave 'Prologue', in I Paul, P Concaicao, K le Goulven & R Mendoza (eds), *Providing Global Public Goods: Managing Globalization* (New York: OUP, 2003), xiii.

19 M Desai "Public Goods: A Historical Perspective", in I Paul & Ors (eds) *Providing Global Public Goods*, above n 18, 69.

and hence the 1994 WTO regime – is characterised by a political commitment to ‘embedded liberalism’ (as opposed to ‘laissez-faire liberalism’).[20] That is, the GATT struck a balance between two competing policy objectives – the first to liberalise trade, and the second to enable intervention in support of domestic stability. The notion was that the desire to liberalise international trade was ‘embedded’ within a larger vision: a shared commitment to social stability as part of the post-WWII order.

This shared vision is written into the text of the GATT through numerous provisions and mechanisms, including the wording of primary obligations such as Article I (MFN) and Article III (national treatment) and the provision for trade remedies and safeguards. But none of the mechanisms is as important as the general exception provision in Article XX, a version of which also appears in GATS as Article XIV. This is augmented by a specific security exception provision in GATT Article XXI and GATS Article XIV bis. It is also reflected elsewhere in the WTO system, for example in Article 2 of the GATS Annex on Financial Services, which permits a Member to take measures for prudential reasons.

Early GATT case law adopted a narrow interpretation of Article XX – and in particular of the word ‘necessary’ in some of its paragraphs.[21] Thus, the first *Tuna/Dolphin* panel found that the US’s embargo on Mexican tuna was not justified as other potential options, such as negotiating an international convention relating to purse seine-net fishing, could have been pursued instead.[22] As we all know, the public outcry was considerable. This outcry was part of the context for the Appellate Body’s own early interventions on Article XX, such as the *Shrimp/Turtle* case which related to Article XX(g) and in which the Appellate Body held that the US’s environmental legislation was not necessarily inconsistent with Article XX(g), although its particular application was not justified.[23]

More significantly, the Appellate Body revisited the definition given to the word ‘necessary’ by these early panels. Thus, in *Korea Beef*, the Appellate Body held that

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[20] See generally A Lang “Reconstructing Embedded Liberalism: John Gerard Ruggie and Constructivist Approaches to the Study of the International Trade Regime” (2006) 9 *J Int’l Econ L* 81.

[21] GATT Panel Report, *US – Section 337 of the Tariff Act of 1930*, GATT Doc L/6439, adopted 7 November 1989, para 5.26.

[22] GATT Panel Report, *US – Restrictions on Imports of Tuna*, GATT Doc DS21/R, 3 September 1991 (not adopted).

[23] Appellate Body Report, *US – Import Prohibition of Certain Shrimp Products*, WT/DS58/AB/R, adopted 6 November 1998.

'necessary' can have a range of meanings from 'indispensible to' to 'making a contribution to'. [24] The Appellate Body concluded:[25]

> In sum, determination of whether a measure, which is not 'indispensible', may nevertheless be 'necessary' within the contemplation of Article XX(d), involves in every case a process of weighing and balancing a series of factors which prominently include the contribution made by the compliance measure to the enforcement of the law or regulation at issue, the importance of the common interests or values protected by that law or regulation, and the accompanying impact of the law or regulation on imports or exports.

In the *EC-Asbestos* case, the Appellate Body confirmed that the more vital or important the common interests or values pursued, the easier it would be to accept as 'necessary' measures designed to achieve those ends. It then held that the public policy objective of preventing health risks from asbestos fibres is 'both vital and important in the highest degree' and that France 'could not reasonably be expected to employ *any* alternative measure if that measure would involve a continuation of the health risk posed by asbestos fibres'.[26]

In the *US-Gambling Services* decision under GATS XIV(a), the Appellate Body explained that the weighing and balancing is affected by the relative importance of the interests and values at stake,[27] and concluded:[28]

> An alternative measure may be found not to be 'reasonably available' ... where it is merely theoretical in nature, for instance, where the responding Member is not capable of taking it, or where the measure imposes an undue burden on that Member, such as prohibitive costs or substantial technical difficulties. Moreover, a 'reasonably available' alternative measure must be a measure that would preserve for the responding Member its right to achieve its desired level of protection with respect to the objective pursued under paragraph (a) of Article XIV.

This approach thus permits members to determine their own domestic policy objectives, and then accords a margin of appreciation to the measures taken to achieve those objectives, with a sliding scale of deference reflecting the relative importance of the interest or values at stake.

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[24] Appellate Body Report, *Korea- Measures Affecting Imports of Fresh, Chilled and Frozen Beef,* WT/DS161,169/AB/R, adopted 10 January 2001, paras 160-164.

[25] Appellate Body Report, *Korea-Beef*, above n 24, para 164.

[26] Appellate Body Report, *EC- Measures Affecting Asbestos,* WT/DS135/AB/R, adopted 5 April 2001, paras 171-174.

[27] Appellate Body Report, *US- Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/AB/R, adopted 20 April 2005, paras 306-307.

[28] *US-Gambling Services*, above n 27, para 308.

IV. The Absence of General Exception Provisions in Investment Treaties

In contrast to the 'New Deal' of the WTO system, BITs are typically written as simple instruments of FDI liberalisation. This reflects an important feature of their development. For the most part, the historical debates over the meaning of customary international law were never resolved through a compromise text. Instead, BITs – the preponderance of which were signed during the Washington Consensus years of the 1990s – reflected the views of capital-exporting states. The bilateral nature of the instruments, and the uneven nature of some of the negotiations, made it inherently less likely that the resulting texts would reflect the more subtle balance of the multilateral GATT.

The result, not to put too fine a point on it, was usually a short text which details investor rights and is rather silent on domestic regulatory autonomy. For instance, the 1990 UK-Argentina BIT, which concisely guarantees national treatment, MFN treatment and freedom from expropriation, does not permit any exceptions save for other trade or customs arrangements, specific bilateral financing agreements and taxation treaties and laws.

There are, of course, good reasons for this drafting style. Investment, unlike trade, involves the investor locating its physical business within the territory of another sovereign power. This is a manifest vulnerability, which many have argued requires manifest guarantees of protection to ensure fair treatment.

Alvarez and Khamsi have set out in great detail the history of the US's BIT program which, for the purposes of this paper, serves as a general approximation of the history of BITs generally.[29] He points out that the US's post-WWII Friendship, Commerce and Navigation (**FCN**) treaties 'explicitly included provisions reflecting U.S. views of what it believed were traditional customary norms protecting aliens' rights to contract sanctity and property'.[30] The first US Model BIT made public in the early 1980s was based on an FCN template, incorporated improvements from European models and now included an investor-state arbitration mechanism.

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[29] See above n 8. It is well-known, of course, that the first BIT was that concluded between the Federal Republic of Germany and Pakistan in 1959: see A Lowenfeld, *International Economic Law* (New York: OUP, 2nd ed, 2008) 554-555.

[30] Alvarez & Khamsi, above n 8, 409.

The purpose of these instruments was not mixed or ambiguous:[31]

> [T]he United States was candid with its prospective BIT parties that concluding a U.S. BIT would not guarantee an increase in incoming FDI flows or necessarily produce tangible benefits such as higher employment. U.S. negotiators were quite clear that the U.S. BIT was not designed to promote economic development or employment as such but was intended to achieve one clear purpose: to protect foreign investment.

The U.S. was explicit that it was promoting in its BITs the US's view of the minimum standards required by customary international law. Accordingly, the US negotiators resisted including provisions which would have permitted derogation from the investor protections they contained. Alvarez and Khamsi thus claim:[32]

> [T]he negotiation of a BIT afforded [the U.S.] an opportunity to secure, at least bilaterally ... absolute guarantees. As U.S. BIT negotiators in this period have repeatedly indicated, the United States was not about to negotiate these away via treaty or to 'balance' investors' rights vis-a-vis the rights of sovereigns, as urged by advocates of a [New International Economic Order] or the concept of 'permanent sovereignty over natural resources'.

Perhaps unsurprisingly, then, several Tribunals, constituted under different treaties, have affirmed the fundamental investment protection objective of the relevant instrument.[33] Even when the Tribunal disavows any intention to interpret a BIT for or against an investor, they are still left with the text. And the text itself is unashamedly pro-investor. See, for instance, the *Azurix* case:[34]

> The Tribunal does not consider that the BIT should be interpreted in favor or against the investor. The BIT is an international treaty and should be interpreted in accordance with the interpretation norms set forth by the Vienna Convention on the Law of the Treaties ('the Vienna Convention'), which is binding on the States parties to the BIT. The Tribunal observes that the BIT itself is an instrument agreed by the two State parties to encourage and protect investment. In the preamble of the BIT, the parties agreed that 'fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment and maximum effective use of economic resources'. Therefore, the BIT itself is a document that requires certain treatment of investment which the parties have considered necessary to 'stimulate the flow of

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[31] Alvarez & Khamsi, above n 8, 411-412.

[32] Alvarez & Khamsi, above n 8, 414.

[33] See, eg, *CMS Gas Transmission Company v The Argentine Republic*, ICSID Case No ARB/01/8 Award (12 May 2005); *Occidental Exploration and Production Company v The Republic of Ecuador*, LCIA Case No UN 3467 Final Award (1 July 2004); *MTD Equity Sdn Bhd and MTD Chile SA v. Republic of Chile*, ICSID Case No ARB/01/7 Award (25 May 2004), para 113; *Metalclad Corporation v. United Mexican States*, ICSID Case No ARB(AF)/97/1 Award (30 August 2000), para 75. See also the decisions cited at Brower, above n 11, n 67.

[34] *Azurix Corp v The Argentine Republic*, ICSID Case No ARB/01/12 Award (14 July 2006), para 307. See a similar passage in *LG&E Energy Corp & Ors v The Argentine Republic*, ICSID Case No ARB/02/1 Decision on Liability (3 October 2006), para 124.

> private capital. The Tribunal in interpreting the BIT must be mindful of the objective the parties intended to pursue by concluding it.

V. Investment Treaty Interpretation without General Exception Provisions

That is not to say that there is no way to balance investor rights against state regulation within existing BITs. Indeed, Newcombe and Paradell go so far as to argue that general exception provisions may be unnecessary because sufficient flexibility already exists within the substantive protections of BITs. This argument is not entirely far-fetched. There is certainly room for balanced interpretation of, for instance, 'like circumstances' in the national treatment guarantee; or fair and equitable treatment.[35] The critical question is whether the creative burden this places on tribunals is too great.

I suggest it is and that a general exception provision would lend a greater coherence and legitimacy to the interpretation process. A signal example of the difficulties for tribunals is the issue of defining indirect expropriation, particularly where the offending measure is a regulation intended to achieve a public objective. The *Santa Elena* case famously sought to tackle the question head on:[36]

> Expropriatory environmental measures – no matter how laudable and beneficial to society as a whole – are, in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state's obligation to pay compensation remains.

In contrast, other tribunals have sought to deem legitimate regulation to be non-expropriatory, even if it has the effect of removing the value of the relevant investment.[37] The reasoning process is now perilously close to incoherent. Thus, the *LG&E* Tribunal confirmed that expropriation in *any* of its modalities requires compensation,[38] but then asserted nine paragraphs later:[39]

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35 Newcombe & Paradell, above n 11, 503-506.

36 *Compañía del Desarrollo de Santa Elena, S.A. v Republic of Costa Rica*, ICSID Case No ARB/96/1; (2000) 15 ICSID Rev Foreign Inv L J 72, 192. See also *Pope & Talbot Inc v Government of* Canada, UNCITRAL/NAFTA Arbitration, Interim Award (26 June 2000), para 99.

37 See, for instance, *Methanex Corp v United States*, UNICTRAL/NAFTA Arbitration, Award (5 August 2005), Part IV, Chapter D, para 15; *Technicas Medioambientales Tecmed SA v The United Mexican States*, ICSID Case No (AF)/00/2, Award (29 May 2003), para 121; and *Marvin Feldman v Mexico*, ICSID Case No ARB(AF)/99/1 Award (16 December 2002), paras 98-99.

38 *LG&E*, above n 34, para 186.

39 *LG&E*, above n 34, para 195.

> With respect to the power of the State to adopt its policies, it can generally be said that the State has the right to adopt measures having a social or general welfare purpose. In such a case, the measure must be accepted without any imposition of liability, except in cases where the State's action is obviously disproportionate to the need being addressed.

This tentative carve-out is fuzzy indeed. Although there is some support for state police powers in customary international law,[40] it is far from clear how and in what form this truly survived BIT codification. Take, for instance, Article 5 of the UK-Argentina BIT.[41] A businessperson reading this text would quite reasonably assume that she would be guaranteed compensation where a governmental action destroyed the value of her business, even if that governmental action was publicly-motivated, proportionate and non-discriminatory. To smuggle into the very definition of indirect expropriation an exception for police powers is arbitrator-fashioned jurisprudence.

The heavy burden placed upon investment treaty tribunals by incomplete BIT drafting has been exposed more starkly in the context of the *Argentina* cases arising out of Argentina's 2001/01 financial crisis. I will focus very briefly on five cases brought by US investors under the US-Argentina BIT: *CMS*,[42] *Enron*,[43] *Sempra*,[44] *LG&E*[45] (all gas sector investors) and *Continental Casualty*[46] (a financial services investor).

The question in each case was whether the measures Argentina took to respond to this crisis – which included terminating the US dollar peso convertibility policy and then pesofying US dollar deposits, freezing bank deposits, prohibiting the transfer of funds overseas and rescheduling interest and debt payments – breached Argentina's obligations under the BIT causing loss to the investor claimant.

Whilst Argentina contested whether its measures *prima facie* contravened any investment protection guarantees in the BIT, the debate centred on whether Argentina's conduct could be justified or excused on the basis of two mechanisms: the customary

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40 *LG&E*, above n 34, paras 196-197.

41 That article provides that '[i]nvestments of investors of the Contracting Party shall not be nationalised, expropriated or subject to measures tantamount to expropriation of nationalisation ... except for a public purpose related to the internal needs of that Contracting Party on a non-discriminatory basis and against prompt, adequate and effective compensation'.

42 *CMS*, above n 33.

43 *Enron Corporation & Anor v The Argentine Republic*, ICSID Case No ARB/01/3 Award (22 May 2007).

44 *Sempra Energy International v The Argentine Republic*, ICSID Case No ARB/02/16 Award (28 September 2007).

45 *LG&E*, above n 34.

46 *Continental Casualty Company v The Argentine Republic*, ICSID Case No ARB/03/9 Award (5 September 2008).

international law doctrine of necessity, encapsulated in Article 25 of the International Law Commission's Draft Articles of State Responsibility; and Article XI of the US-Argentina BIT, which is a non-precluded measures exception for essential security interests. As the cases show, however, neither provision is well adapted to the modern debate over the intersection between investor rights and regulatory autonomy.

The findings of the five Tribunals can be briefly summarised as follows:

Case	**Breaches**	**Justification/excuse**	**Damages**	**Annulment**
CMS	FET (II(2)(a)) Umbrella clause (II(2)(c))	No	US$133m	Application filed; not annulled[47]
Enron	FET (II(2)(a)) Umbrella clause (II(2)(c))	No	US$106m	Application filed; pending
Sempra	FET Umbrella clause	No	US$128m	Application filed; pending
LG&E	FET Discriminatory and arbitrary treatment (II(2)(b)) Umbrella clause	State of necessity existed between December 2001 and April 2003, leading to no liability under Article XI for measures taken during this period	US$57m	Application filed; pending but suspended on 12 June 2009 due to parties' agreement
Continental Casualty	FET, with respect to specific losses only	State of necessity existed leading to no liability under Article XI	US$2.8m	Application filed for partial annulment; pending

It is interesting to compare excerpts from the Tribunals' respective reasoning on the necessity/non-precluded measures issue. The *CMS* Tribunal held:[48]

> The Treaty in this case is clearly designed to protect investments at a time of economic difficulties or other circumstances leading to the adoption of adverse measures by the Government. The question is, however, how grave these economic difficulties might be. A severe crisis cannot necessarily be equated with a situation of total collapse. And in the absence of such profoundly serious conditions it is plainly clear that the Treaty will prevail over any plea of necessity [....] As stated above, the Tribunal is convinced that the Argentine crisis was severe but did not result in total economic and social collapse. When the Argentine crisis is compared to other contemporary crises affecting countries in different regions of the world it may be noted that such other crises have not led to the derogation of international contractual

47 Though some negative comments were made by the *Ad Hoc* Annulment Committee: *CMS Gas Transmission Company v The Argentine Republic*, ICSID Case No ARB/01/8 Decision of the Ad Hoc Committee (25 September 2007), paras 101-136.

48 *CMS*, above n 33, paras 354-355.

> or treaty obligations. Renegotiation, adaptation and postponement have occurred but the essence of international obligations has been kept intact.

The CMS Annulment Committee observed that the CMS Tribunal had made several legal errors in its consideration of Article XI and customary international law, but that the threshold for annulling an award had not been reached.[49]

The *Enron* Tribunal held:[50]

> The Tribunal has no doubt that there was a severe crisis and that in such context it was unlikely that business could have continued as usual. Yet, the argument that such a situation compromised the very existence of the State and its independence so as to qualify as involving an essential interest of the State is not convincing. Questions of public order and social unrest could be handled as in fact they were, just as questions of political stabilization were handled under the constitutional arrangements in force. … 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.

An almost identical passage appears in the decision of the *Sempra* Tribunal.[51]

The *LG&E* Tribunal held:[52]

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

In *Continental Casualty*, perhaps the most interesting decision for present purposes, the Tribunal held:[53]

> Since the text of Art. XI derives from the parallel model clause of the U.S. FCN treaties and these treaties in turn reflect the formulation of Art. XX of GATT 1947, the Tribunal finds it more appropriate to refer to the GATT and WTO case law which has extensively dealt with the concept and requirements of necessity in the context of economic measures derogating to the obligations contained in GATT, rather than to refer to the requirement of necessity under customary international law.

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49 *CMS Annulment Decision*, above n 47, paras 128-136.

50 *Enron*, above n 43, paras 306, 308 and 331.

51 *Sempra*, above n 44, paras 348 and 350.

52 *LG&E*, above n 34, para 239.

53 *Continental Casualty*, above n 46, para 192.

The Tribunal then went on to quote excerpts from the Appellate Body decisions in *Korea-Beef*, *EC-Asbestos* and *US-Gambling*.[54] It concluded that the WTO weighing and balancing approach should be imported into its analysis in determining 'whether the Measures contributed materially to the realization of [Argentina's] legitimate aims under Art. XI of the BIT, namely the protection of the essential security interests of Argentina in the economic and social crisis it was facing'.[55]

Given my professed admiration for the GATT/WTO approach to exceptions, one might suppose I would support the *Continental Casualty* approach. But, in fact, I share the misgivings of Alvarez and Khamsi, who submit that:[56]

> Article XX of the GATT is grounded in a balancing test that is absent from the test of the U.S.-Argentina BIT's Article XI. Article XI suggests an on/off switch; either a measure is 'necessary' for the stipulated reasons or it is not. Nothing in it suggests the balancing test implied in the preamble of GATT's Article XX … or in the lengthy laundry list of exceptions contained in the rest of Article XX (which presumably extend beyond the usual customary law defences).

In contrast, the Tribunal in *Enron* concluded: [57]

> [i]n examining this discussion, the Tribunal must first note that the 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 international 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.

This seems harsh.[58] But it also appears to reflect the original intent of the parties to the BIT – or specifically, the US negotiators. My problem is not so much with the inconsistency between the five decisions, but for the lack of firm textual basis grounding them. All of these Tribunals appear to be trying to do too much with too little. First, recourse was swiftly had to Article 25 of the ILC Draft Articles, which were applied by the *CMS* Tribunal like a statute to the exclusion of the actual words in Article XI. Then the *Continental Casualty* Tribunal chose effectively to apply WTO caselaw, notwithstanding the very different contexts of the two systems.

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54 *Continental Casualty*, above n 46, paras 193-195.

55 *Continental Casualty*, above n 46, para 196.

56 Alvarez & Khamsi, above n 8, 441.

57 Alvarez & Khamsi, above n 8, 441.

58 And this has been specifically criticised by Newcombe & Paradell, above n 11, 485.

It is apparent from reading any of these decisions how woolly and unsettled this area of interpretation is.[59] Like Newcombe and Paradell, the respected authors of another textbook claim that 'general concepts [contained in BITs] do in fact contain within them considerable flexibility. This enables arbitrators to balance the public and the private interest, and to ensure that the treaty provisions retain their role as a safety net, leaving a considerable margin of appreciation for the exercise of state sovereignty'.[60] But this leaves the key policy issues to arbitrator discretion and it is far from clear that arbitrators are the most suitable policy-makers. As Charles Brower has written:[61]

> [w]hen compared to the open and systematic application of interpretative principles favouring the protection of foreign investment, pursuit of the public interest through hints and veiled reference suggest that tribunals regard it as a tertiary consideration in resolving investment disputes. Furthermore, the subtextual motivations of individual tribunals provide no stable or rigorous framework for consideration of the public interest, even as a tertiary factor, in future investment disputes.

In a system with *ad hoc* adjudicators and no right of appeal, stakeholders need to have confidence that these tribunals will pay close attention to the text and not be distracted by exogenous sources. But it is obviously difficult for arbitrators to do so if the text they must interpret is incomplete and one-sided. The present drafting of BITs cries out for judicial creativity.

Much as I value creativity, I prefer the more explicit approach already taken by some BITs and FTA. Although most do not contain general exceptions clauses,[62] some now do. For instance, Canada's BITs habitually include general exception provisions based on Article 10 of the 2003 Canadian Model Agreement.[63] The same is true for the investment chapters of the two FTAs signed by New Zealand – the NZ/China and ASEAN-Australia-NZ FTA – the former of which expressly subjects the investment regulation to GATT Article XX and both of which include Annexes defining indirect appropriation.[64] The

[59] See, eg, Muchlinski, above n 13, 53 ('investment tribunals, dealing with investor-state litigation following the Argentine financial crisis, have not come to very clear or satisfactory conclusions on this crucial point regarding the effectiveness of IIAs').

[60] C McLachlan QC, L Shore and M Weiniger *International Investment Arbitration: Substantive Principles* (Oxford: OUP, 2007), 23.

[61] C Brower, above n 11, 360-361.

[62] Newcombe & Paradell, above n 11, 500.

[63] Article 10(1) of the Canadian Model Agreement for the Promotion and Protection of Investment.

[64] Article 200 of the NZ-China Free Trade Agreement, entered into force from 1 October 2008; Articles 1-5, Chapter 15 of the ASEAN-Australia-NZ Free Trade Agreement, not yet in force.

2004 US Model BIT does not include a broad general exception provision, but does contain expanded exception provisions in Articles 12, 13, 18 and 20, as well as a detailed Annex B defining indirect expropriation.[65] The Norwegian Draft Model BIT had included such a provision also,[66] but it has recently been withdrawn – due, sadly, to the failure to find stakeholder consensus on several drafting issues.

VI. Implications and Concluding Thoughts

What is largely absent in investment law is what is now a staple of trade law – the "investment and" debate.[67] There is insufficient principled discussion of how international investment law connects with other values and objectives. One reason this is missing is the absence of a legal mechanism which provides a focus for detailed analysis. Accordingly, the reasoning in most BIT cases lacks the coherence and resonance of the leading Appellate Body decisions.

This section addresses – rather more shortly – what underlying philosophy should motivate the next generation of BIT text. In saying this, I believe that there is a limit as to what can be done with many of the older generation of treaties. Certainly, there is room for a balancing process within some of the substantive investment rights provided and the existing non-precluded measures clauses. Equally certainly, some assistance can be gained from 'general concepts', customary international law and previous cases. But the scope for legitimate creativity is confined.

The BIT landscape is, however, changing faster than many participants might think. The text of today's Model BITs is important not only as a template for new agreements, but as an example of what might be renegotiated by individual states. Many existing BITs have limited lives – such as the UK-Argentina BIT, which may now be terminated by either party on twelve months notice. The midst of a global recession is a good time to reassess how these agreements might be written. It is also likely in the coming years that many BITs will be superseded, or at least augmented, by FTAs containing investment

65 US 2004 Model Bilateral Investment Treaty. The Energy Charter Treaty (done at the Hague, signed 17 December 1991) includes an exception but this does not extend to the treaty's provisions on expropriation: see Article 24. See also Article 83 of the Japan-Singapore Economic Partnership Agreement, entered into force on 20 November 2002.

66 Article 24 and note 6 of the draft Norwegian Model Bilateral Investment Treaty, issued for comment on 19 December 2007.

67 Though see A Reinisch '"Investment and..." – the Broader Picture of Investment Law', in A Reinisch & C Knahr (eds) *International Investment Law in Context* (Vienna: Eleven, 2007), 203.

chapters. And it is possible that a wider form of MFN clause could allow *state parties* to benefit from more favourable exception clauses in other BITs.

At present, most BITs deliberately represent a laissez-faire liberalism, rather than the embedded liberalism of the WTO system. Some, such as Vandevalde, are unhappy with this philosophical approach – but only because BITs do not go far enough in single-mindedly pursuing the goal of investment liberalisation.[68] Others, of course, take the opposite view. To turn again to Professor Ruggie, this time in his capacity as Special-Representative of the UN Secretary-General for Business and Human Rights:[69]

> [R]ecent experience suggests that some treaty guarantees and contract provisions may unduly constrain the host Government's ability to achieve its legitimate policy objectives, including its international human rights obligations. That is because under threat of binding international arbitration, a foreign investor may be able to insulate its business venture from new laws and regulations, or seek compensation from the Government for the cost of compliance. A Norwegian draft model agreement and commentary address such concerns about bilateral investment treaties [and] stresses the vulnerability of developing countries to agreements 'that tie up political freedom of action and the exercise of authority ...'.

The concept informing Ruggie's comments, and the now-defunct Norwegian draft, is really that of sustainable development. It would be a mistake to dismiss this out of hand. Defined in the 1987 Brundtland Report as 'development that meets the needs of the present without compromising the ability of future generations to meet their own needs',[70] explicated in the 1992 Rio Declaration on Environment and Development,[71] affirmed in the 2002 Monterrey Consensus[72] and further developed in the 2008 Doha Declaration on Financing for Development[73] – sustainable development has become a defining issue for the present wave of globalisation. Although it has most closely been identified with environmental issues, it is a much broader idea. Indeed, through the human development theory constructed by Amartya Sen and others, development has been identified with the

68 See K Vandevalde, 'Political Economy', above n 12, 636-640.

69 Report of the Special Representative of the Secretary-General *Business and Human Rights*, A/HRC/11/13 (23 April 2009), paras 29-31.

70 Report of the Brundtland Commission, *Our Common Future* (Oxford: OUP, 1987) ch 2, para 1.

71 United Nations Conference on Environment and Development, "Rio Declaration on Environment and Development", Annex 1 of *Report of the UNCED*, done at Rio de Janeiro, 3-14 June 1992, A/CONF.151/26.

72 *Report of the International Conference on Financing for Development*, Monterrey, Mexico, 18-22 March 2002, E.02.II.A.7, A/CONF.198/11.

73 *Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus*, Doha, Qatar, 29 November-2 December 2008, A/CONF.212/L.1/Rev.1.

basic human desire for freedom. On this view, development is an increase of basic capabilities and wealth which facilitates the expansion of substantive freedoms.[74] Sustainable development occurs when, on numerous levels, this increase in substantive freedoms happens in an incremental and permanent way.

Many agree that 'the development dimension of IIAs remains to be more fully realised'.[75] Certainly, international investment is not a virtue in and of itself. Its value is as a means to an end; the question being, how to define that end? I suggest that, just as Ruggie's embedded liberalism has become the philosophical basis for WTO law, Sen's human development theory could be a lodestar for international investment law.

But even if one rejects Sen's theory, one should not reject the concepts of clarity, predictability and longevity that are commonsense principles of good treaty drafting. There is a pressing need to better define the appropriate balance between investor and state interest in the international investment. That balance may be different than for the international trade context. One need not go so far as to embrace IISD's Model Investment Agreement,[76] or even the Norwegian draft, to appreciate that some form of wording is better than none. While there may be a legitimate debate as to how best to craft such a provision, the debate should be had.

Looking to the long term, Vandevalde has argued that the principal benefit of a BIT is 'stabilization' of the investment environment.[77] But how stable really is a system which is textually one-sided and relies upon beneficent interpretation by *ad hoc* tribunals to redress the balance? In this regard, I have in mind Amy Chua's thesis that investment disputes are cyclical, and a privatisation-nationalisation dynamic is the inexorable consequence of domestic political forces (including ethnic rivalries).[78] If so, it is not in the long-term interest of investors to override domestic political issues by investment rights – even if it may lead to short-term gain. If BITs do not adequately provide for the balancing

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74 A Sen *Development as Freedom* (New York: Anchor Books, 1999), 14, 19-20, 33 and 225.

75 Muchlinski, above n 13, 48.

76 See *IISD Model International Agreement on Investment for Sustainable Development* (Second Edition, 2006), Article 25, available at http://www.iisd.org/pdf/2005/investment_model_int_handbook.pdf. This provision is intended to affirm the inherent right to regulate, rather than be a mere general exception provision, allegedly on the basis that even the WTO approach is too restrictive. See Newcombe & Paradell, above n 11, 503, fn 89.

77 K Vandevalde 'Investment Liberalization and Economic Development: the Role of Bilateral Investment Treaties' (1998) 36 Colum L Rev 501, 522.

78 A Chua 'The Privatization-Nationalization Cycle: The Link Between Markets and Ethnicity in Developing Countries' (1995) 95 Colum L Rev 223.

of competing interests, the inevitable balancing process may take place with considerably less subtlety outside of the international investment system – for instance by countries such as Bolivia and Ecuador pulling out entirely.[79]

To conclude, public goods are part of the international political economy. Indeed, much of the contemporary debate is turning towards how to ensure provision of global public goods – such as a sustainable climate – in our interconnected, globalised world. BITs cannot address this larger problem, but they can seek to ensure that public, as well as private goods, are adequately and expressly taken into account in what is an important, but still immature, form of international regulation of domestic state action.

[79] Perhaps in favour of the Venezuela-led Bolivarian Alternative for the Americas. See, eg, M Alvaro 'Ecuador will become a member of ALBA on June 24, 2009' *Dow Jones*, at http://www.easybourse.com/bourse-actualite/marches/ecuador-will-become-member-of-alba-on-june-24-688651.