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Investment Agreements (IIAs) and
Financial Crises

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PANEL II: EXCEPTION CLAUSES

CONCEPT OF NECESSITY IN INVESTMENT ARBITRATION: The Competing Interests of Investors and Host States

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TWO CONTEXTS:

CUSTOMARY INTERNATIONAL LAW DOCTRINE OF NECESSITY

- ALL CASES ARGUED ON THIS BASIS
- AS DISCUSSED, SOME CONFUSION WITH THE ELEMENTS OF THE TREATY-BASED EXCEPTION

TREATY-BASED EXCULPATORY PROVISIONS

- PRIMARILY ESSENTIAL SECURITY DEFENSE, BUT ALSO EMERGENCY/STRIFE DEFENSE
- PRINCIPALLY EMPLOYED AS A MERITS-BASED DEFENSE

INVESTORS AND STATES MAY AGREE AS TO CONCEPT
UNDER CUSTOMARY INTERNATIONAL LAW

THAT IS, IT'S EMBODIMENT IN ILC ARTICLE 25 DRAFT
ARTICLES ON RESPONSIBILITY OF STATES FOR
INTERNATIONALLY WRONGFUL ACTS

INVESTORS AND STATES DISAGREE ON:

- CHARACTER: SELF-JUDGING? NEXT PANEL WILL ADDRESS
- APPLICATION OF THE EXCEPTION/DEFENSE
- SCOPE [Will Start with Art. 25]
- BUT PRIMARY FOCUS OF ARGUMENTS HAS BEEN CIL DEFENSE [The existence of alternative measures and State's “contribution” to crisis]

FOCUS OF THIS PRESENTATION IS DISAGREEMENT OVER APPLICATION OF BOTH THE CIL DEFENSE AND TREATY EXCEPTION, PANEL III WILL DISCUSS ISSUES IN RESPECT OF WHETHER A PROVISION IS SELF-JUDGING OR NOT

FIRST, BECAUSE IT IS PRESENT IN ALL CASES WE EXAMINE VIEWS OF INVESTORS AND HOST STATES WITH RESPECT TO THE APPLICATION OF THE CUSTOMARY INTERNATIONAL LAW DOCTRINE OF NECESSITY AS ENSHRINED IN ARTICLE 25

KEY STARTING POINT ISSUE UNDER BOTH CIL AND TREATY ANALYSIS IS WHETHER EXCEPTION APPLIES TO ECONOMIC CRISES OR WHETHER LIMITED TO NATIONAL SECURITY

- Perhaps surprisingly, there is general agreement by investors that Defense/Exception COULD apply to economic crisis, but depends on PARTICULAR context

LET'S LOOK AT ARGENTINA

BACKGROUND OF FINANCIAL CRISES DURING 2000/2001 TO 2003

First, in early 1990s, in response to a prior crisis, privatization including of gas, gas transportation sector (and including electricity sector)

Dollar-denominated contracts/licenses

Contracts to be adjusted for inflation based on U.S. producer price index (PPI)

NEXT: End of 1990s, Asian Financial crisis/rise of dollar/devaluation of Brazilian real (a primary export market for Argentina, and general collapse in emerging markets)

RESULTS:

OVER A PERIOD OF 1-3 YEARS STARTING AT END BEGINNING OF MILLENIUM:

GDP plummeted

Public fiscal debt

Run on banks (by December '01)

Unemployment estimated at 25%

Wages decreased 70% from October 2001 to May 2002

50% of population fell below poverty level

Domestic consumption down 20%

Successive resignation of 4-5 presidents

RIOTS resulting in thousands of death

“break-up” from IMF

MEASURES TAKEN BY ARGENTINA IN RESPONSE:

- Suspension of Dollar-denomination of contracts and PPI Adjustment (started in 2000)
- “Corralito” - Freeze on withdrawals and exchange controls imposed
- Emergency Law
- Persification

ELEMENTS OF ARTICLE 25: May not be invoked to preclude wrongfulness of an act *unless*

- only way to safeguard essential interest against a *grave and imminent peril*
- does not impair essential interest of other State Party OR international community as a whole
- Cannot be invoked if obligation excluded or State contributed to the situation

NECESSITY – COMPETING INTERESTS [Art. 25]

Argentina argues:

- Economic crisis was essential interest because gravity created peril of major societal breakdown

Investors argue that:

- Economic crisis may, under certain circumstances, be sufficiently grave as to constitute a peril but not in this case

NECESSITY – COMPETING INTERESTS

Argentina argued that pesification of contracts, and other emergency measures were the only way to avert disaster

Investors argue that alternatives – such as dollarization of economy, subsidies to affected industries, and other measures were available

NECESSITY – COMPETING INTERESTS

Argentina argued that actions of its government did not contribute to the financial crisis (or severity of the crisis)

Investors argued that government mistakes at the very least contributed to the severity of, if not the crisis itself

LOOKING SPECIFICALLY AT *CONTINENTAL CASUALTY*

INVESTOR'S view was that security was meant to encompass external threats AND, invoking Art. 25 ILC, if other means, even if more costly or less convenient, are available then Argentina cannot avail itself of defense

- Alternatives included debt exchange, devaluation, full dollarization

ARGENTINA (raised as a merits defense)

Alternatives under Art. 25 not feasible

Measures excused under Art. XI I BIT

[Unlike LG +E and others, dealt first with treaty defense, since if valid and absolved Argentina,

APPLICATION: TRIBUNAL HELD THAT

“essential security interest” includes not only political and military security, but also economic security of States and their population” [noting that LG+E AND CMS ALSO RECOGNIZE ECONOMIC CRISES AS ESSENTIAL SECURITY INTEREST]

Argentina met conditions for derogation under Art. XI and Art. 25's “contributory negligence” element not applicable

Treaty-based Exceptions (for example, Argentina- US BIT)

Article XI: This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order . . . or the protection of its own essential security interests.

First, a general description of the parties' arguments

Argentina argued that Art. XI is *lex specialis* for operation of necessity/emergency situations through which provisions of the Treaty do not apply, and no compensation is necessary

Investors argued that an “essential security interest,” entails war or natural disaster, its operation in this context is contrary to the object and purpose of the Treaty, and in any event does not exempt from liability

More Specifically, in the *LG + E* case

INVESTOR ARGUED THAT: Article XI not applicable to economic crisis; “Necessary” means only option available under Article XI; and “public order” relates to safeguarding public health and Argentina’s measures were not aimed at calming domestic situation, so not necessary to maintain public order

ARGENTINA argued that from 1998-2003 a state of political, economic, and social crisis existed and that excused liability under Art. XI

Public order affected because basic infrastructure was dependent on natural gas energy so had to modify distribution agreements or risk collapse in that sector

TRIBUNAL HELD THAT FROM DECEMBER 2001 TO APRIL 2003 Argentina was in a crisis that required measures to maintain public order and protect essential security interests

- Serious public disorders, not merely “economic problems” or “business cycle fluctuations”
- Extremely severe crises in the economic, political (executive as well as legislative) and social sectors which reached apex in 12/01 threatening total collapse of the Government and the Argentine State

drug prices soared, hospitals suffered severe shortages of basic supplies (govt. declared health emergency)

Street protests/civil unrest

SO, ARTICLE XI APPLICABLE AND ARGENTINA EXCUSED