PART I

General interests of host States in the application of investment treaties

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The application of BITs in time of economic crisis: limits to their coverage, necessity and the relevance of WTO law

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1. Introduction

The limits to the coverage of investment protection provisions in Bilateral Investment Treaties (BITs) and more generally in International Investment Agreements (IIAs) have attracted increasing attention recently.[1] There are various reasons for this development.

First of all, the increase in the number of BITs in place and their growing invocation by aggrieved foreign investors in direct arbitration against host States has shifted the focus from the content of individual provisions to a reflection on their scope in general. Secondly, economic crises have led to renewed intervention by States in the economy, at times affecting negatively foreign investors in particular. The question of whether or in what respect the granting to foreign investors through BITs of fair and nondiscriminatory treatment and specific commitments may limit the discretion of governments in adopting needed anticrisis measures, which may entail differential treatment of creditors and limitations to previous benefits, has naturally surfaced. Although the measures adopted by many economies to face the financial crisis that exploded in 2008 have not given origin to major disputes yet, the issue is not merely academic or relevant only for the drafting of new treaties.[2]

1 For simplicity we will refer here to BITs (Bilateral Investment Treaties) to refer also generally to investment chapters of broader agreements (such as the investment chapters of the NAFTA and KORUS) and to the four investment agreements signed by ASEAN countries between themselves, with Australia and New Zealand, with Korea and with China in 2009, often referred to as International Investment Agreements (IIAs).

2 See: Bjorklund (2009); Van Aaken and Kurtz (2009, 2010); Kurtz (2010). As to the relevance of international monetary and financial rules for the interpretation and application of BITs, such as found in the IMF, the GATS and its Annex on Financial Services, and the OECD Liberalization Codes, see Sacerdoti (2013).

The debate has started with the investment disputes generated by the economic crisis of Argentina in 2001 related to the measures taken during the crisis and in its aftermath. The de-dollarization of that economy, the restructuring of public debt and the freezing of public tariffs have been challenged by a number of foreign investors as being in breach of relevant BITs entered into by Argentina in the previous decade. In these cases Argentina has invoked the crisis as the basis for its defense that the relevant BIT's provisions were inapplicable, or that their application should take into account the situation of crisis. Ensuing awards and annulment decisions of some of them at the International Centre for Settlement of Investment Disputes (ICSID) have given divergent answers, showing different approaches and interpretations of similar or identical texts by different arbitral tribunals and *ad hoc* committees.[3] Notwithstanding a certain trend to coherence in some respects, conclusions reached remain apart on several issues.

Similar cases concerning other countries could occur in the future when governments feel compelled to give precedence to coping with pressing needs of economic stability at the price of sacrificing foreign investors' rights and expectations, even if backed by treaty assurances.[4] From a different point of view, it is important for (prospective) investors to understand how much protection is granted by these treaties in cases of crisis and how good fair treatment and protection from expropriation clauses are in order to cover them from encroachment by host States in these situations. The issue is whether the guaranteed treatment and rights may be invoked irrespective of any unexpected economic evolution, even if resulting in a situation of dire crisis and emergency, or whether in such a situation host States' actions may be admitted as a legitimate, possibly necessary, exercise of State regulatory powers of the economy in the pursuit of paramount noneconomic objectives.[5]

3 For a critical view of these divergences see Crivellaro (2011).

4 There have been indications in the press of the introduction of investment cases against Greece and Cyprus under the BITs of those countries challenging measures taken in the recent crises; see "Crisis in Cyprus. Will bank depositors find shelter under BITs?" 2013 *Global Arbitration Review*, 8(3), 7.

5 More generally, even the constitutional commitments to spending discipline under the 2012 "Fiscal Compact" (Treaty on Stability, Coordination and Governance), between twenty-five members of the European Union allow relaxing the agreed discipline in "exceptional circumstances." Art. 3(3)(b) defines them as "an unusual event outside the control of the Contracting Party, which has a major impact on the financial position of the general government or to a period of severe economic downturn." The implementing Italian constitutional provision allows accordingly derogations in case of "exceptional events, among which [are] serious economic recession, financial crises, major natural disasters."

These crucial issues concerning on the one hand the value of the BIT for investors, and on the other the hurdles that these treaties may impose to governments struggling to cope with a crisis, have been raised first jurisprudentially on a case-by-case basis, with hardly any support from precedents and literature.[6]

In view of the existing stock of BITs in force, it is unlikely that the issue will be resolved promptly through replacement or amendment, that is, updating of existing BITs. It will thus be for adjudicators in case of disputes concerning specific or general regulatory measures taken by host States to give a case-by-case answer by interpreting existing provisions, mostly not focused on the issue of their application in time of economic crisis.

Our analysis will proceed reviewing in turn:

- the type of measures to which States may resort and have resorted, as well as BITs, protection standards that may be affected thereby (Section 2);
- the relevant BITs, provisions as to their coverage, including specific exceptions (such as the "non-precluded measures" provision in Art. XI of the US–Argentina BIT) that may limit their application in time of economic crises (Sections 3 and 4);
- the relevance of the defense of necessity, especially as applied in the Argentinean cases (Section 5);
- the reference to WTO law for interpretative purposes in order to balance investors' expectations and the protection of general interest of host States (Section 6).

2. Measures taken in respect of economic and financial crises affecting foreign investors' rights and BITs' protection

There is not a single definition of "economic crisis."[7] Economic, financial and banking crises are different phenomena but may be closely related, one prompting the other. In the context of the present chapter it is the

6 Only three international decisions, rather far dating, are known to have addressed such issues, *Ottoman Public Debt Arbitration* (1925) 1 UNRIAA 529; *Serbian Loans* (1929) PCIJ Ser. A No. 20 and *Brazilian Loans* (1929) PCIJ Ser. A No. 21. For a critical view of their use by the ILC in drafting the provision on necessity (Art. 25) of the ILC Draft Articles on State Responsibility see Sloane (2012) 106 AJIL 447. For an historical overview, see Sacerdoti (1972), 132 ff.

7 For a review see IMF (2008), "World Economic Outlook. Financial Crises: Causes and Indications," 74 ff.

"extraordinary" measures taken by governments in those situations, to prevent or cope with a crisis, that interest the most.

Past crises, including situations of severe balance of payment problems, offer a broad picture of measures that may affect treaty rights of foreign investors. The recent financial crisis offers further examples. Measures involved may be of the following type:

- limitations of current payments;
- limitations of capital transfers;
- rescue/reorganization of (only) selected national financial institutions ("too big to fail");
- sovereign default and debt restructuring;
- currency redenomination;
- prudential measures for the stability of the financial sector and/or specific intermediaries.[8]

Such measures might breach the fair and equitable treatment standard, requiring a tribunal to evaluate whether normative or regulatory changes, or rather their impact on the investor, were fair or not.[9] These measures may entail also violation of nondiscrimination (national treatment) obligations, as has been hinted in respect of US and EU measures in support of domestic financial institutions in crisis.[10] In more radical instances restrictive measures may amount to indirect expropriation through regulation ("regulatory taking").[11] The distinction between breach of the fair

8 Adoption of such measures implies normally using the flexibilities allowed by international monetary and financial regulation (EU, GATS, IMF, OECD), following the procedure prescribed and obtaining the support of the competent institutions; see Sacerdoti (2013). Prudential measures are those taken "with respect to financial services, including measures for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial institution or enterprise, or to ensure the integrity and stability of the financial system." See OECD, Negotiating Group on the Multilateral Agreement on Investment (MAI), "The Treatment of Prudential Measures in the MAI," DAFFE/MAI/EG5(96)1, October 7, 1996, available at: www.oecd.org/daf/mai/pdf/eg5/eg5a961e.pdf. See generally Viterbo (2012).

9 Several ICSID tribunals have taken this approach. See in this respect *Generation Ukraine* v. *Ukraine*, ICSID No. ARB/00/9, Award, September 16, 2003, 20.37; *MTD Equity SDN and MTD Chile S.A.* v. *Republic of Chile*, ICSID No. ARB/01/7, Award, May 25, 2004, 178; *Parkerings-Compagniet* v. *Lithuania*, ICSID No. ARB/05/8, Award, September 11, 2007, 308; *Paushok* v. *Mongolia*, UNCITRAL Award, April 28, 2011, 305.

10 See communication from the EU Commission on the application, from January 1, 2012, of State aid rules to support measures in favor of banks in the context of the financial crisis, OJ 2011/C 356/02.

11 In *Saluka Investments B.V.* v. *Czech Republic*, UNCITRAL Award on Jurisdiction, March 17, 2006, 465–467, the legitimacy of a measure addressed to the support of a domestic

and equitable treatment standard (FET) and indirect expropriation is typically based on the level of incidence on the right to property.[12]

On the other hand these measures may be legitimate regulatory action, not entailing any breach of a BIT, also in the light of the specific language of certain instruments. Thus the European Convention of Human Rights (ECHR/CEDU) excludes from the protection against expropriation non-discriminatory regulatory action adopted in the general interest.[13] In the same vein, the US 2004 BIT Model provides that nondiscriminatory regulatory actions to protect legitimate public welfare objectives (health, safety, environment) do not constitute indirect expropriation "except in rare circumstances."[14] Finally these measures may be carved out from the coverage of a treaty by an "essential interests" clause, as will be examined hereunder.

Measures affecting foreign investments protected under a BIT or an IIA taken in time of an economic crisis raise the question of the relevance of the object and purpose of BITs for the interpretation and hence the application of such treaties in emergency situations.

financial institutions to the detriment of other foreign similar entities was found in breach of FET.

12 Investment case law is rather consistent in this respect. See as to Argentina's measures taken during the 2001 crisis: *LG&E* v. *Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, October 3, 2006, 191, where it is stated that "[i]nterference with the investment's ability to carry on its business is not satisfied where the investment continues to operate, even if profits are diminished. The impact must be substantial in order that compensation may be claimed for the expropriation"; *BG Group Plc* v. *Argentina*, UNCITRAL, Award, December 24, 2007, 258–266; *Enron* v. *Argentina*, ICSID Case No. ARB/01/3, Award, May 22, 2007, 245. See also *Tecmed* v. *Mexico*, ICSID Case No. ARB (AF)/00/2, Award, May 29, 2003, 115; *CME Czech Republic B.V.* v. *Czech Republic*, UNCITRAL, Partial Award, September 13, 2001, 604; *Goetz and others* v. *Burundi*, ICSID Case No. ARB/95/3, Award, February 10, 1999. Beyond ICSID see *Starrett Housing Corp.* v. *Iran*, Award, August 14, 1987, 4 Iran–US CTR 122, 154–157; *Tippets, Abbett, McCarthy, Stratton* v. *TAMS-AFFA Consulting Engineers of Iran*, Award, June 29, 1984, 6 Iran–US CTR 219, 255. For doctrinal views see Leben (2006), 173; Dolzer and Schreuer (2008), 96–101.

13 See Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms, as amended by Protocol No. 11, Paris 20 March 1952, Art. 1: "The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

14 *2004 US Model BIT, Annex B,* available at: www.state.gov/documents/organization/117601.pdf. See also Canada, *Foreign Investment Promotion and Protection Agreement Model,* 2003, available at: italaw.com/documents/Canadian2004-FIPA-model-en.pdf.

The basic question is whether, in the absence of a specific clause, the relevant standards – fair and equitable treatment, nondiscrimination and the prohibition of indirect expropriation – may, or should be applied differently in respect of measures taken to avert or cope with an economic crisis.[15] The issue is how to balance the purpose of protecting covered investment by ensuring stability and predictability of the investment regime of the contracting States with other noneconomic values and concerns of host States, especially when they face major crises.[16]

As stated recently by an investment tribunal, it is obvious that the stability established by a BIT cannot be total "especially when extraordinary circumstances appear."[17] Case law shows that the issue is far from settled. In the absence of specific exceptions for measures taken in case of crisis in the relevant BIT, various arbitral tribunals have expressed different views, notably as to whether and how Argentina's 2001 crisis was relevant for evaluating whether certain measures affecting foreign protected investors were fair or not.[18]

15 For an application of this approach see *Total* v. *Argentina*, ICSID Case No. ARB 04/0, Decision on Liability, December 27, 2010, 160–165. The arbitrators held there that an investor in utilities in Argentina could not have a "legitimate expectation" that the dollar peg of the tariffs would be maintained also in case of a crisis such as Argentina went through (in absence of explicit promises to that effect). The BIT at issue, between France and Argentina, does not contain a "security exception" or "non-precluded measures" clause.

16 See *Total* v. *Argentina* (fn 15) 115, based on a detailed analysis of the preamble of the France–Argentina BIT:

> signatories of such treaties do not thereby relinquish their regulatory powers nor limit their responsibility to amend their legislation in order to adapt it to change and the emerging needs and requests of their people in the normal exercise of their prerogatives and duties. Such limitations upon a government should not lightly be read into a treaty which does not spell them out clearly nor should they be presumed.

For a different view see *Occidental Exploration and Production Company* v. *The Republic of Ecuador*, LCIA Case No. UN 3467, Final Award, July 1, 2004, which relies explicitly on the language of the preamble of the US–Ecuador BIT in order to hold that "the stability of the legal and business framework is thus an essential element of fair and equitable treatment."

17 *El Paso Energy International Company* v. *Argentina*, ICSID Case No. ARB/03/15, Award, October 31, 2011, 614–615 (with reference to the preamble of the US–Argentina BIT).

18 In *British Gas (BG) Group* v. *Argentina* (fn 12), issued under the UK–Argentina BIT (which does not contain an essential security exception), the Tribunal took a strict view of the legal principles applicable to the matter. On the other hand the *Total* Tribunal (fn 15) under the France–Argentina BIT (not containing such a provision either) took a more flexible position as recalled at fn 15. The *BG* Award found that pesification (de-dollarization) of tariffs established in dollars was a breach of the fair and equitable treatment, while the *Total* Decision held the contrary. For an "intermediate" position

Two different approaches have been proposed in respect of the application of BITs in case of economic and financial crisis.[19] According to the first approach, the protection afforded by BITs should be upheld when it is most needed, that is when a government might incline to have foreign investors paying the highest price in case of crisis disregarding previous commitments. According to the other view, a government's discretionary policy space should be safeguarded precisely when the general interest is most endangered.

3. Limitations to the coverage of BITs relevant to their application in case of crisis

We come now to limitations to the application of BITs stemming from general or specific limits to their coverage spelled out in their text, which may affect their coverage *ratione* (a) *personae*, (b) *temporis*, (c) *materiae*, (d) *loci*.

In case of dispute, the limits of coverage are in principle relevant as a jurisdictional limit since a tribunal has no competence to entertain a dispute if the matter submitted to it is outside the boundaries of the subject matter that contracting States have regulated in the treaty. Viewed differently, the claimant would lack the substantive right it invokes because the treaty does not attribute such rights to investors of either party.[20]

There is an abundant case law on those limits being raised in investment disputes, leading to decisions upholding or declining jurisdiction as the case may be. Relevant boundaries are not always clear: in several well-known cases there have been split decisions by the tribunals on the matter, leading to forceful dissents.[21] Such jurisdictional issues concern,

see *National Grid* v. *Argentina*, UNCITRAL Award, November 3, 2008, also an award under the UK–Argentina BIT.

19 See Burke-White and von Staden (2007).

20 Rule 41 of the ICSID Arbitration Rules defines an objection to jurisdiction as one "that the dispute is not within the jurisdiction of the Centre or, for other reasons, is not within the competence of the Tribunal" as a Preliminary Objection to be raised "as early as possible" in the proceedings.

21 See *Tokios Tokeles* v. *Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction, April 29, 2004, in which jurisdiction was upheld notwithstanding the fact that the Lithuania-based claimant company was owned by Ukrainian nationals, against the dissent of the president of the Tribunal, Professor Prosper Weil, who resigned thereafter; *Abaclat and Others* v. *Argentina*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, August 4, 2011, in which jurisdiction was upheld against the dissent of arbitrator Professor Georges Abi-Saab, who also resigned thereafter.

as to (a), whether the claimant is a national of the other party to the BIT.[22] As to the temporal issue (b), an issue which has been raised more than once is whether the investment was made or the alleged breach occurred before or after the entry into force of the treaty when the relevant BIT contains a temporal limit in that respect.[23] As to subject matter jurisdiction (c): the issue is whether the dispute concerns the subject matter to which the treaty applies, such as an "Economic Activity in the Energy Sector" under the Energy Charter Treaty.[24] A similar issue is whether the dispute pertains to a subject matter which is explicitly excluded, such as sometimes taxation[25] or gambling.[26] Finally, the territorial requirement (d) is relevant as to whether the investment was made "in the territory" of the host State, as defined in the BIT.[27]

Some limitations are specifically relevant in respect of measures that may be enacted in time of crisis, even if such limitations may not have been intended to protect signatories from obligations limiting their discretion to take measures in such a situation. This is the case of provisions that exclude from coverage the financial sector or financial assets, such as treasury bills or bonds issued by public entities. Some BITs exclude explicitly sovereign debt from the treaty's coverage.[28] NAFTA in contrast

22 See *Soufraki* v. *UAE*, ICSID Case No. ARB/02/7, Award, July 7, 2004, under the BIT between Italy and the UAE, where the Tribunal found it lacked jurisdiction because the claimant had lost his Italian nationality before the alleged breach had occurred.

23 See *Jan de Nul* v. *Arab Republic of Egypt*, ICSID Case No. ARB/04/13, Decision on Jurisdiction, June 16, 2006. Another issue of temporal application of a BIT may concern the date when the dispute arose when the treaty does not cover those that arose before its entry into force, see *Lucchetti* v. *Peru*, ICSID Case No. ARB/03/4, Award, February 5, 2005.

24 Energy Charter Treaty, Art. 1 (Definitions) (6).

25 In *El Paso* v. *Argentina* (fn 17) 291, the Tribunal took note that as to tax matters Art. XII(2) of the US–Argentina BIT excludes, except in special and limited cases (such as indirect expropriation which was not found *in casu*), any review of possible violation of the fair and equitable treatment, while Art. XII(1) "creates only a best-effort obligation."

26 See for instance the exclusion of gambling from the scope of the US–Republic of Korea Free Trade Agreement, Letter from Hyun Chong Kim to Susan Schwab, June 30, 2007, available at: www.ustr.gov/sites/default/files/uploads/agreements/fta/korus/asset_upload_file993_12732.pdf

27 See *Abaclat and Others* v. *Argentina* (fn 21) 379–380, holding that the investment in bonds issued by Argentina abroad complied with the territorial coverage of the BIT between Italy and Argentina as "investments made in the territory of the Contracting Parties" because of the contribution made to Argentina's economy. For a critical view see De Luca (2012). For the general proposition that restructuring of foreign public debt should not be covered by BITs and their arbitration clauses, but rather left to the traditional methods used in case of States' default, see Waibel (2007).

28 Canada–Colombia FTA (2008), Art. 838, fn 11; Australia–Chile FTA (2008), Art. 10(1)(j)(iii); Azerbaijan–Croatia BIT (2007). See generally UNCTAD, "Sovereign Debt