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CURRENT LEGAL DEVELOPMENTS

Two Worlds of Necessity in ICSID Arbitration: *CMS* and *LG&E*

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Abstract

Two recent ICSID cases, *CMS* v. *Argentina* and *LG&E* v. *Argentina*, diverge on the application of necessity under customary international law. The *LG&E* tribunal affirmed that Argentina's financial crisis amounted to a state of necessity. On virtually identical facts, *CMS* had reached the opposite conclusion 18 months earlier. This unhealthy split of opinion highlights the fact that necessity is ill-suited to financial crises. The state of necessity is at best a crude defence, appropriate as long as international law in this area remains underdeveloped. Lack of payment capacity will strike a better balance between host country and investor interests in future sovereign debt crises. This defence is also more amenable to adjudication by national courts and international tribunals.

Key words

Argentina; debt crises; fair and equitable treatment; financial crises; International Centre for the Settlement of Investment Disputes; payment capacity; sovereign debt restructuring; state of necessity; utility tariffs

In 2001 and 2002 Argentina experienced an unprecedented economic crisis. The government introduced a range of emergency measures to prevent economic and social collapse. Affected foreign investors initiated many arbitrations against Argentina. About 45 cases are currently pending before the International Centre for the Settlement of Investment Disputes (ICSID).[1]

Two recent ICSID awards on liability diverge sharply on necessity as a ground for precluding international wrongfulness. On 3 October 2006, the *LG&E* tribunal affirmed that Argentina's financial crisis amounted to a temporary state of necessity under general international law and the emergency clause of the Argentina–United

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1. The list of pending ICSID cases is found at http://www.worldbank.org/icsid/cases/pending.htm. For an early overview of ICSID cases brought against Argentina, see R. D. Bishop and R. A. Luzi, 'Investment Claims: First Lessons from Argentina', in T. Weiler (ed.), *International Investment Law and Arbitration – Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (2005), 425. Argentina's total potential liability in these arbitrations is several dozen billion US dollars.

States bilateral investment treaty (BIT).[2] Eighteen months earlier, the *CMS* tribunal had declined necessity on virtually identical facts.[3]

This comment critically analyses the divergent interpretation and application of necessity in *LG&E* and *CMS*. The focus is on necessity under customary international law.[4] The split of opinion between the two tribunals indicates that international investment law on 'financial necessity'[5] is in flux. *LG&E* could represent a net departure from the principle and the traditionally high threshold for necessity. The comment concludes that necessity is at best a crude instrument for dealing with sovereign financial crises. While the defence of necessity is generally seen as part of customary international law,[6] necessity is ill-suited to balance appropriately interests of investors and countries in sovereign financial distress.

The section following provides the essential factual background for understanding the different approach to financial necessity taken by the *CMS* and *LG&E* tribunals.

1. *CMS* AND *LG&E*: BACKGROUND AND AWARDS

ICSID cases against Argentina originate almost exclusively in the country's financial crisis in 2001/2. At the heart of the investment disputes in *LG&E* and *CMS* is the suspension of tariff adjustments in privatized utility companies. This question attracted particular controversy within and outside Argentina. Countries whose investors had bought stakes in Argentine utility companies brought considerable pressure to bear on policy-makers and international institutions for an upward adjustment of these tariffs. Argentina, on the other hand, maintained that the tariff freeze was essential for it to resolve its unprecedented economic crisis.

The facts in *LG&E* v. *Argentina* and *CMS* v. *Argentina* are virtually identical.[7] In *LG&E*, three US corporations had acquired equity stakes in several Argentinian gas companies.[8] CMS, another US corporation, had purchased shares in TGN, an Argentine gas transportation company operating under government licence. From

2. *LG&E Energy Corp., LG&E Capital Corp., and LG&E International Inc. v. Argentina*, ICSID Case No. ARB/02/1, Award, 3 October 2006, 46 ILM 36 (2007) (hereinafter *LG&E*).
3. *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Award, 12 May 2005, 44 ILM 1205 (hereinafter *CMS*).
4. Argentina also relied on necessity based on Article XI in the Argentina–United States BIT (Treaty between United States of America and The Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment, 14 November 1991, entered into force 20 October 1994, 31 ILM 124 (1992), available at http://www.unctad.org/sections/dite/iia/docs/bits/argentina_us.pdf (last visited 28 February 2007)). The BIT emergency clauses raise questions beyond the scope of this comment; for an overview, see A. Reinisch, 'Necessity in International Investment Law – An Unnecessary Split of Opinions in Recent ICSID Cases? Comments on *CMS v. Argentina and LG&E v. Argentina*', (2007) 81 *Journal of World Investment* 191.
5. In the following, the term 'financial necessity' is used for illustrative purposes only. It is not necessary here to take a position on whether dividing necessity into subcategories adds value. S. Heathcote, 'State of Necessity and International Law', Ph.D. thesis, Geneva University, 2005, at 231–54, discusses financial necessity as a specific variant of general necessity. Another variant is environmental necessity; see M. Montini, *La necessià ambientale nel diritto internazionale e comunitario* (2001).
6. See Art. 25, International Law Commission Articles on State Responsibility (hereinafter ILC Articles).
7. Reinisch, *supra* note 4, at 3–4; and S. Schill, 'International Investment Law and the Host State's Power to Handle Economic Crises – Comment on the ICSID Decision in *LG&E v. Argentina*', (2007) 24 *Journal of International Arbitration* 211, at 214, highlight this point.
8. For details, see *LG&E*, *supra* note 2, paras. 33 ff.

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the late 1980s onwards, Argentina privatized many public utilities. In the gas sector, two gas transmission and eight distribution companies were to operate under long-term licences. The independent gas regulator EMARGAS was set up to oversee the application of the legal framework.

Under these licences and the legal framework in the gas sector, tariffs were to be calculated in dollars. Conversion to pesos was to be effected according to the US Producer Price Index (US PPI) on billing. The Argentine Convertibility Law[9] established a currency board with dollar–peso parity. Before the outbreak of the crisis the Argentine government had negotiated two voluntary temporary tariff freezes with the gas distribution companies. Shortly after the crisis hit, Argentina suspended gas tariff adjustments altogether.[10]

Argentina's 2002 Emergency Law abolished peso–dollar convertibility.[11] All dollar-denominated claims were converted into pesos at a rate of 1:1. Argentina insisted on renegotiation of the legal framework for utilities to safeguard an 'essential interest of the State when threatened by grave and imminent peril'. The emergency law's sole purpose, according to Argentina, was to bring 'under control the chaotic situation that would have followed the economic and social collapse that Argentina was facing'.[12] Foreign investors challenged the freeze on PPI adjustments and the restrictions on foreign exchange before ICSID.[13] In *CMS* and *LG&E* it was argued that these government measures amounted to expropriation and to a violation of fair and equitable treatment.[14]

Both tribunals dismissed the claim of expropriation. Argentina's measures did not amount to an indirect taking, since the investors retained control and ownership of their investments.[15] Argentina's actions were, however, found to be in breach of the fair and equitable treatment obligation, because the legal framework in the utilities sector applicable to the investments was entirely transformed.[16] By passing the convertibility law and guaranteeing PPI tariff adjustments, Argentina had created 'specific expectations among investors' which were frustrated by the emergency measures.[17]

The *CMS* tribunal explained that in making sweeping changes to the business and legal environment in the gas sector, on which CMS had relied for investing in Argentina, the host country had breached its obligation of according fair and equitable treatment to foreign investors;[18] Argentina had failed to provide the stable

9. Law No. 23.928, 27 March 1991, modified by Law No. 25.445, 21 June 2005.
10. *CMS*, *supra* note 3, paras. 60 ff. Since January 2000 nominal gas tariffs have not been adjusted.
11. Law No. 25.561, 6 January 2002, *Bolltín Official* (Argentina) No. 29.810.
12. *CMS*, *supra* note 3, paras. 305–6.
13. Decree No. 669/2000, suspending US PPI adjustment. Emergency Law No. 25.561, 6 January 2002, declaring a state of necessity and restricting the use of foreign exchange. *CMS*, *supra* note 3, para. 61; *LG&E*, *supra* note 2, para. 60.
14. Argentina–United States BIT, *supra* note 4, Arts. IV and II(2)(a). Arbitrary and discriminatory treatment (Art. II (2)(b)) was also alleged, but is not examined here.
15. *CMS*, *supra* note 3, para. 263; *LG&E*, *supra* note 2, para. 200.
16. *CMS*, *supra* note 3, paras. 139, 275, 281; *LG&E*, *supra* note 2, paras. 124 and 133.
17. *LG&E*, *supra* note 2, para. 133.
18. *CMS*, *supra* note 3, paras. 275 and 281.

and predictable investment climate required under the BIT. The tribunal awarded CMS US$149 million in compensation, including US$16 million in interest.

The *LG&E* tribunal reasoned that 'Argentina went too far by completely dismantling the very legal framework constructed to attract investors'.[19] 'Argentina had prepared with the investment banks [charged with the privatizations] an attractive framework of laws and regulations that addressed the specific concerns of foreign investors with respect to country risks involved in Argentina.'[20] Abrogating the calculation of tariffs in dollars, the semi-annual PPI adjustments, and the undertaking to set tariffs at levels commensurate with a reasonable rate of return violated fair and equitable treatment.

Yet the *LG&E* tribunal outlined an important caveat. The guarantee of the regulatory framework is subject to the general limitation of the host state's existence: 'the stability of the legal and business framework is an essential element of fair and equitable treatment in this case, provided that they do not pose any danger for the existence of the host State itself'.[21] According to this view, necessity indirectly feeds into the interpretation of the fair and equitable treatment obligation.

Section 2 examines whether necessity is a valuable tool for resolving sovereign debt crises.

2. Necessity and sovereign debt crises

Necessity as a circumstance precluding state responsibility is well rooted in customary international law.[22] The ILC Articles on State Responsibility include necessity as one of seven circumstances precluding wrongfulness. In the *Gabcikovo-Nagymaros* judgment and the *Security Wall* advisory opinion, the International Court of Justice (ICJ) affirmed that the articles of the International Law Commission (ILC) reflect customary international law.[23] *CMS* and *LG& E* follow the ICJ's lead on the customary status of necessity.[24]

Necessity comes into play when an essential state interest is in grave and imminent peril. A state faced with such peril may be excused for not living up its

19. *LG&E*, *supra* note 2, para. 139. Specifically by abrogating guaranteed tariff calculation in dollars contained in Decree No. 1738/92, 18 September 1992, and an outright freeze on tariff adjustments before and after December 2001 and April 2003, coupled with pressures on the companies to renegotiate their licences.
20. *LG&E*, *supra* note 2, para. 133.
21. Ibid., para. 124.
22. Special Rapporteur Ago included necessity in article 33 of his proposal for codification of the law on state responsibility, (1980) ILC Yearbook, vol. II, Part Two, at 34. Special Rapporteur García Amador had inserted a provision on necessity in his Draft Articles on Diplomatic Protection (see Art. 17(2) (1961) ILC Yearbook vol. II, 1, at 48); also R. Jennings and A. Watts, *Oppenheim's International Law* (1992), Vol. 1 (Peace), 499 ff.; see Strupp, 'Les règles générales du droit de la paix', (1934-I) 47 RCADI 259, at 567, for an early definition of necessity. Heathcote, *supra* note 5, traces necessity's historical evolution from antiquity to the present, at 307–71.
23. *Gabcikovo-Nagymaros Project (Hungary/Slovakia)*, Judgment, 25 September 1997, [1997] ICJ Rep. 7 (hereinafter *Gabcikovo*) paras. 51–52; *Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory*, Advisory Opinion, 9 July 2004, [2004] ICJ Rep. 136, para. 140. See also Commentaries to the Draft Articles on Responsibility of States for Internationally Wrongful Acts, Adopted by the International Law Commission at Its Fifty-Third Session (2001), Official Records of the General Assembly, Fifty-Sixth Session, Supplement No. 10 (UN Doc. A/56/10), at 195 (hereinafter ILC Commentaries), 195–200.
24. *CMS*, *supra* note 3, para. 315; *LG&E*, *supra* note 2, para. 245.

international obligations. On balance, non-performance of the international obligation is subordinated to an essential state interest. Pleas of necessity are strictly scrutinized to protect against abuse.[25] Also, the state invoking necessity is not the sole judge of whether its conditions are met.[26] Yet many international lawyers remain sceptical about the doctrine, especially in view of past abuses.[27]

The law on necessity grew out of state practice on the use of force and the right to self-defence.[28] As a result of this origin, transposing necessity to the economic and financial sphere raises many complications. If past awards by international courts and tribunals are any guide, necessity is essentially inoperative even in times of extreme economic turbulence.[29] While the *Russian Indemnity Award* recognized that *in principle* extreme financial distress could amount to necessity, non-payment of a loan was unjustifiable in the particular circumstances.[30] The only important arbitral award which did in fact apply 'financial necessity' is the 1902 *French Company of Venezuela Railroads* case.[31]

As will be explained below, current international law on necessity is ill-suited to deal with 'financial necessity'.

2.1. The time dimension of necessity

There is general agreement that necessity precludes wrongfulness for a limited time only.[32] The temporal limitation of necessity is one of the few points on which the *CMS* and *LG&E* awards are congruent. In *CMS*, the tribunal held that 'even if the plea of necessity were accepted, compliance with the obligation would reemerge as soon as the circumstances precluding wrongfulness no longer existed, which is the case at present'.[33] Similarly, in *LG&E*, the tribunal stressed that necessity 'should be only strictly exceptional and should be applied exclusively when faced with extraordinary circumstances'.[34]

This temporal limitation makes perfect sense in a use-of-force context. Once the threat recedes, the international obligation to preserve the peace revives. The

25. Necessity is 'subject to strict limitations to safeguard against possible abuse'. ILC Commentaries, *supra* note 23, at 195.
26. A number of cases affirmed that necessity is not self-judging: *Gabcikovo*, *supra* note 23, para. 51; *Case Concerning Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. United States of America)*, Merits, Judgment, 27 June 1986, [1986] ICJ Rep. 14, para. 282; *CMS*, *supra* note 3, paras. 370–4.
27. ILC Commentaries, *supra* note 23, at 183; Heathcote, *supra* note 5, at 83–4.
28. B. Rodick, *The Doctrine of Necessity in International Law* (1928); and P. Weidenbaum, 'Necessity in International Law', (1938) 24 *Transactions of the Grotius Society: Problems of Peace and War* 105, emphasize the doctrine's origin in the use of force.
29. See *Société Commerciale de Belgique (Belgium v. Greece)*, Judgment, 15 June 1939, PCIJ (Series A/B) No. 78 (1939), 160–90; *Oscar Chinn (United Kingdom v. Belgium)*, Judgment, 12 December 1934, PCIJ (Series A/B) No. 63 (1934), 65, at 113 (separate opinion Judge Anzilotti); *Serbian Loans Case (France v. Kingdom of Serbs, Croats and Slovenes)*, Judgment, 12 July 1929, PCIJ (Series A) No. 20/21 (1929), 1–89, at 38–42.
30. *Russian Indemnity (Russia v. Turkey)*, Award of the Arbitral Tribunal of 11 November 1912, (1913) 7 AJIL 178.
31. *French Company of Venezuela Railroads (France v. Venezuela)*, 10 UNRIAA 285.
32. See Art. 27(a) of the ILC Articles, which states that reliance on necessity is 'without prejudice to compliance with the obligation in question, if and to the extent that the circumstances precluding wrongfulness no longer exist'; *Gabcikovo*, *supra* note 23; ILC Commentaries, *supra* note 23, at 189; A. Reinisch, *State responsibility for debt* (1995), at 69; J. Kämmerer, 'Der Staatsbankrott aus völkerrechtlicher Sicht', (2005) 65 *Zeitschrift für ausländisches öffentliches Recht und Völkerrecht* 651, at 659.
33. *CMS*, *supra* note 3, para. 382.
34. *LG&E*, *supra* note 2, paras. 228 and 263.

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same rationale does not apply to economic distress. Financial necessity could in effect replicate a temporary stay on the enforcement of financial obligations, like insolvency law in municipal law. When a government faces a liquidity crunch, necessity could thus provide useful breathing space for reorganizing the maturity profile of the country's financial obligations.

However, in sovereign debt crises linked to genuine lack of payment capacity, this temporal limitation of necessity risks being counterproductive. If a government's aggregate financial obligations remain unchanged, little is achieved. In such circumstances, the effect of a subsequent revival of all financial obligations could be to impede a fresh start for the country concerned. If unsustainable debt is not resolved by a partial write-down, necessity could unnecessarily prolong the country's financial woes. Importantly, this 'muddling through' may not only adversely affect the country and its population, but also foreign investors.

2.2. The 'no contribution' requirement

Article 25(2)(b) of the ILC Articles excludes the plea of necessity if the state itself contributed to necessity; a state cannot invoke necessity if its own contribution is substantial.[35] This is another requirement of the necessity defence in customary international law which is difficult to transpose to the economic area. Unsurprisingly, *CMS* and *LG&E* diverge in applying this principle.

The *CMS* tribunal concluded that Argentina's 'policies and their shortcomings significantly contributed to the crisis and the emergency and while exogenous factors did fuel additional difficulties they do not exempt the Respondent from its responsibility in the matter'.[36] Thus Argentina's contribution was sufficiently substantial to be taken into account. The tribunal explained that 'similar to what is the case in most crises of this kind the roots extend both ways and include a number of domestic as well as international dimensions. This is the unavoidable consequence of the operation of a global economy where domestic and international factors interact.'[37]

Equally unsatisfactory is the finding in *LG&E*, where the tribunal only briefly remarked that no 'serious evidence in the record [indicates] that Argentina contributed to the crisis resulting in the state of necessity'.[38] The tribunal bridged its lack of substantive analysis by relying on a dubious burden of proof rule.[39] Accordingly, the foreign investor needs to demonstrate that the host country contributed to the crisis. For all practical purposes, such proof is impossible. And even if the investor could furnish this proof, tribunals would soon encounter the obstacle that they lack jurisdiction to assess the adequacy of macroeconomic policies. Reinisch rightly comments that both awards fail to analyse the requirement of contribution in any depth.[40]

35. The ILC Commentaries take the view that 'incidental or peripheral' contribution is not enough; *CMS* in this respect follows the ILC Commentaries, *supra* note 23, para. 328.
36. *CMS*, *supra* note 3, para. 329.
37. Ibid. para. 328.
38. *LG&E*, *supra* note 2, para. 257.
39. Ibid., para. 256; Reinisch, *supra* note 4, at 13.
40. Reinisch, *supra* note 4, at 12.

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On a more general level, it is doubtful whether analysis of the host country's contribution, even if undertaken, will yield valuable insight for applying the doctrine of necessity to sovereign debt crises. Macroeconomists will still be arguing about the causes of and solutions for Argentina's financial crisis in twenty years' time. While the *CMS* tribunal correctly identified concurrent domestic and international roots for most sovereign debt crises, this insight is neither deep nor novel, and offers little assistance for applying necessity.[41] No ICSID tribunal will ever be able to disentangle the exogenous and endogenous causes of such crises. This lends further support to the view that the requirement of 'no significant contribution' is ill-suited to the economic field.

2.3. Compensation for measures taken in necessity

The two tribunals diverged on yet another crucial point: the question whether compensation was due for measures taken in a state of necessity.

CMS held that 'the plea of necessity may preclude the wrongfulness of an act, but it does not exclude the duty to compensate the owner of the right which had to be sacrificed'.[42] This would be tantamount to the investors bearing 'the cost of the plea of the essential interests of the other Party'.[43] The *LG&E* tribunal disagreed with this interpretation of Article 27(b) of the ILC Articles, and found that 'the damages suffered during the state of necessity should be borne by the investor'.[44] It is possible that the *LG&E* tribunal reached a different result simply because in its view Article XI of the Argentina–US BIT took precedence over Article 27(b) ILC Draft.[45]

Here again, the limitations of necessity in a financial context become apparent. Under *CMS*'s reading, necessity has no bearing on the requirement to compensate. It will be obvious that this interpretation does little to help a country in financial distress. At the same time, it is unclear whether a general shifting of the risk onto the investor, as envisaged in *LG&E*, is warranted. As the concluding remarks will show, necessity in many ways misses the crucial point. What the tribunals could have done, and indeed should have done, was to engage in a detailed analysis of Argentina's payment capacity. This approach offers firmer ground for liability to foreign investors and avoids the numerous pitfalls of necessity when applied to sovereign debt crises.

Section 3 summarizes the two opposing paradigms of necessity adopted in *CMS* and *LG&E*.

3. Two worlds of necessity

While both *CMS* and *LG&E* agree on extending necessity into the economic realm, their application of necessity to sovereign financial distress differs markedly. The implications of this split are potentially far-reaching. The conclusion will put forward a few implications.

41. *CMS*, *supra* note 3, para. 328.
42. Ibid., para. 384 ff.; see also *Gabcikovo* case, where the ICJ found that necessity 'would not exempt [Hungary] from its duty to compensate its partner', *supra* note 23, at 39.
43. *CMS*, *supra* note 3, para. 390.
44. *LG&E*, *supra* note 2, para 264.
45. Ibid., para. 260; Schill, *supra* note 7, at 20.

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Precedents for the use of emergency powers in turbulent economic times are numerous.[46] These situations test the law and the courts to their limits. International investment law, although evolving rapidly, remains less developed than administrative and constitutional law in the domestic realm. Recognition of these inherent tensions will cast in a more sympathetic light the struggle faced by the *LG&E* and *CMS* tribunals in balancing widely varying interests.

3.1. An essential security interest and economic emergencies

CMS adopted the following approach. It first asked whether an essential security interest of Argentina was at stake. This required evaluating the gravity of Argentina's financial crisis and its social and political implications. If the likely outcome was a 'major breakdown', then invocation of necessity might be justified.[47] Even though the tribunal opined that the crisis was 'severe', it nevertheless held that there was not a threat of 'total economic and social collapse'.[48] The tribunal failed to investigate this key question in any depth and dismissed Argentina's necessity defence.

The *CMS* tribunal introduced through the back door an intermediary category of necessity: circumstances which 'without being catastrophic in and of themselves, nevertheless invite catastrophic conditions in terms of disruption and disintegration of society, or are likely to lead to a total breakdown of the economy'.[49] The tribunal relied in part on the disagreement among experts in support of this conclusion: 'leading economists are of the view that the crisis was of catastrophic proportions; other equally distinguished views, however, tend to qualify this statement'.[50] Leben called this a 'Solomonic solution', which would permit the tribunal to lower compensation due for Argentinian measures as long as they responded to a genuine crisis and were taken in good faith.[51]

It is doubtful whether there is much utility in this distinction. What may appear at first sight as a balanced solution is in truth a disguised and erroneous short cut. The *CMS* tribunal clouded its reluctance to decide substantively on necessity in philosophical terms:

> As is many times the case in international affairs and international law, situations of this kind are not given in black and white but in many shades of grey. It follows that the relative effect that can be reasonably attributed to the crisis does not allow for a finding on preclusion of wrongfulness.[52]

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46. After the First World War, which led to declarations of necessity in many European states, necessity migrated to the economic realm. In France, for instance, the Poincaré government requested emergency powers to deal with the franc crisis in 1924. After initial resistance, the parliament relented and renounced its economic powers for a period of four months. Similarly, the financial reconstruction in Austria involved the transfer of significant economic powers from parliament to the executive and the League of Nations. See G. Agamben, *Stato di eccezione* (2003); English translation, G. Agamben, *State of Exception* (2005), at 20–1. In the United States, the New Deal and the concomitant policy battles pitted the Roosevelt administration against the Supreme Court.
47. *CMS*, *supra* note 3, para. 319.
48. Ibid., paras 320 and 355.
49. Ibid., para. 354.
50. Ibid., para 320.
51. C. Leben, 'L'État de nécessité dans le droit international de l'investissement', (2005) 349 *Gazette du Palais* 19, at 20.
52. *CMS*, *supra* note 3, para. 321.

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Be that as it may, 'shades of grey' are omnipresent in international life and do not justify glossing over Argentina's plea of necessity.

LG&E, by contrast, adopted a broad conception of essential security interests. These interests are not limited to traditional security interests; rather, they include 'economic, financial or those interests related to the protection of the State against any danger seriously compromising its internal or external situation'.[53] The tribunal emphasized that essential interests are tied to the specific circumstances of each case:

> [A]n interest's greater or lesser essential [*sic*], must be determined as a function of the set of conditions in which the state finds itself under specific situations. The requirement is to appreciate the conditions of each specific case where an interest is in play, since what is essential cannot be predetermined in the abstract.[54]

The tribunal reached the conclusion that Argentina's dire economic circumstances amounted to a state of necessity for 15 months between 2001 and 2003: 'The essential interests of the Argentine State were threatened in December 2001. It faced an extremely serious threat to its existence, to its political and economic survival, to the possibility of maintaining its essential services in operation, and to the preservation of its internal peace.'[55] The tribunal based its conclusion on Argentina's economic plight: its inability to refinance the huge stock of foreign debt, massive unemployment, capital flight, and a precipitous drop in economic output.

3.2. The 'only way' criterion and the adequacy of economic policies

Necessity requires that the measure taken was the only way of safeguarding an essential interest.[56] The two tribunals struggled with the 'only way' criterion in the financial context. Arbitrators in both cases were well aware that they lacked the jurisdiction to pass judgment on the adequacy of Argentina's economic policy measures. The *CMS* tribunal had stressed earlier that it lacked 'jurisdiction over measures of general economic policy adopted by the Republic of Argentina and cannot pass judgment on whether they are right or wrong'. In an ingenious twist the *CMS* tribunal left little substance to this very jurisdictional limitation. The tribunal found that it could examine whether 'measures of general economic policy having a

53. *LG&E*, *supra* note 2, para. 251. The tribunal emphasized that to hold that 'such a severe economic crisis could not constitute an essential security interest is to diminish the havoc that the economy can wreak on the lives of an entire population and the ability of the Government to lead. When a state's economic foundation is under siege, the severity of the problem can equal that of any military invasion' (para. 238).

54. Ibid., para. 252.

55. Ibid., paras. 228 and 257, found that the state of necessity began on 1 December 2001 and ended on 26 April 2003, when President Kirchner was elected. The tribunal thus limited the temporal scope of necessity. Thereafter Argentina is 'no longer exempted from responsibility for any violation of its obligations under the international law and shall reassume them immediately'.

56. Both *CMS* and *LG&E* affirm this prerequisite. *CMS*: necessity is 'excluded if there are other (otherwise lawful means) available, even if they may be more costly or less convenient' (*supra* note 3, para. 324). *LG&E* took a similar view: 'the act must be the only means available to the state in order to protect an interest' (*supra* note 2, para. 250). *Gabcikovo* rejected the necessity defence on the grounds that Hungary would have had other measures at its disposal (*supra* note 23, para. 55).

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direct bearing on such investment have been adopted in violation of legally binding commitments made to the investor in treaties, legislation or contracts'.[57]

Under the *CMS* approach, the availability of several policy alternatives, and support by various experts for different measures, obviated the need to examine the adequacy of macroeconomic policy in deciding on the applicability of necessity. Divergent views among distinguished economists by themselves indicate that policy was not limited to a single alternative, and thus preclude invocation of necessity. As such divergence of views lies in the nature of economic policy, the *CMS* test is essentially meaningless. Whenever there is at least one other policy alternative, the effect of the *CMS* holding is to shut the door on necessity almost completely.

Taken to its logical conclusion, this approach leads to the absurd result that necessity is barred simply because ICSID tribunals lack the jurisdiction to assess economic policy alternatives. Circumstances in which a government will have one, and only one, policy measure at its disposal will be extremely rare. Necessity will then be limited to situations where economic and social order has entirely collapsed. This interpretation in effect ties policymakers' hands until the scale of the crisis has reached huge and uncontrollable proportions. It is most difficult to see this as serious balancing of investors' and the host country's interests.

In *LG&E*, the pendulum swings in the other direction, pushing the door wide open to necessity. The tribunal found that 'an economic recovery package was the only way of responding to the crisis. Although there may have been a number of ways to draft the economic recovery plan, the evidence before the Tribunal demonstrates that an across-the-board response was necessary, and the tariffs on public utilities had to be addressed.'[58] Independent of the policy package adopted by the government, necessity is available.[59] This approach of course pays very little heed to the 'only way' criterion under customary international law.

While the tribunal exercises due restraint with respect to economic policy measures, it might just have gone too far. According to *LG&E*'s standard, the country has almost limitless flexibility in deciding whether the measures were the 'only way' of safeguarding an essential security interest. By analysing this requirement through the lens of the burden of proof, the *LG&E* tribunal leaves much leeway for the host country. Ordinarily, the party relying on an exception bears the burden of proof. This was the approach taken in *CMS*, where the host country is required to show that its economic circumstances reach the level of necessity. *LG&E* reverses this rule, with tenuous justification.[60] Under this approach, necessity could in effect become self-judging, inviting abuse.

57. *CMS Gas Transmission Company v. Argentine Republic*, Case No. ARB/01/8, Decision on Jurisdiction, 17 July 2003, 42 ILM 788 (2003), para. 33. *CMS*, *supra* note 3, para. 323: 'Which of these policy alternatives would have been better is a decision beyond the scope of the Tribunal's task, which is to establish whether there was only one way or various ways and thus whether the requirements for the preclusion of wrongfulness have or have not been met.'
58. *LG&E*, *supra* note 2, para. 257.
59. Ibid., para. 240.
60. Schill, *supra* note 7, at 18–19.

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4. Conclusion

While ICSID awards do not possess the force of precedent, ICSID tribunals frequently rely on their persuasive authority. Therefore two aspects of the *LG&E* decision are particularly striking. First, it mentions *CMS* only in passing.[61] On necessity, *LG&E* does not cite *CMS* at all. Given that the facts were nearly identical and that the two awards were close together in time, *LG&E* should clearly have referred more extensively to *CMS*. Second, this deliberate ignoring of an earlier decision in a similar case is even more disturbing, given that the ICJ judge Francisco Rezek served as Argentina-appointed arbitrator in both cases.[62]

Brief mention should also be made of recent bondholder litigation in municipal courts. Necessity plays a prominent role in a number of lawsuits against Argentina in German courts. There, Argentina has consistently argued that its financial crisis amounted to a state of necessity under international law, justifying suspension of payments on its external bonds.[63] The lower German courts submitted to the German Bundesverfassungsgerichtshof (Federal Constitutional Court) the question as to whether a state of necessity pronounced by the debtor country justified non-payment of financial obligations to private bondholders.[64]

This split on the application of the necessity plea is deeply worrying for international investment law. Such conflicting outcomes will undoubtedly reinforce calls for an appellate body in investment arbitration *à la* WTO.[65] The split further undermines legal certainty and fuels concerns about the legitimacy of investment treaty arbitration. Both tribunals failed to explain adequately their findings on necessity – they were bound to examine in detail why Argentina's financial crisis might or might not have endangered essential security interests. It is highly unlikely that a convincing legal analysis of this question will fit into a few paragraphs.

In its application for annulment of the *CMS* award, Argentina invoked among other things an erroneous application of necessity.[66] The *CMS* annulment panel, which is currently sitting, faces a significant challenge. In view of the large number

61. The only reference to *LG& E* in *CMS* is in the discussion of fair and equitable treatment, *CMS*, *supra* note 2, para. 125. Schill, *supra* note 7, at 24, highlights that *LG&E*'s reliance on ICSID case law is selective. 'Whenever it concurred with the award in *CMS v. Argentina*, the Tribunal in *LG&E* invoked its support, whenever it disagreed with the earlier decision, it did not even mention it.'

62. The same experts also submitted opinions on necessity, including José Alvarez, Ann-Marie Slaughter with William Burke-White, and Nouriel Roubini.

63. E.g. LG Frankfurt am Main, 2–21 O 381/02, 31 October 2003, (2004) 15 NJW-RR, 1053, and comment by A. Reinisch, 'Wirksamkeit eines Arrestbefehls gegen den Staat Argentinien', (2003) 58 *Juristenzeitung* 969.

64. The judgment in these cases is expected in 2007. In an earlier decision that attracted widespread attention, the Constitutional Court had ruled that Berlin's financial woes did not amount to serious financial distress justifying additional support payments by other German states (Bundesverfassungsgericht, 2 BvF 3/03, 19 October 2006). It remains to be seen whether the Court will draw on this judgment for the Argentine bondholder cases.

65. Reinisch, *supra* note 4, at 22–3; see also ICSID Secretariat, Possible Improvements of the Framework for ICSID Arbitration, Discussion Paper, dated 26 October 2004, paras. 20–23, available at http://www.worldbank.org/icsid/highlights/improve-arb.pdf (last visited 28 February 2007); C. Tams, 'An Appealing Option? The Debate about an ICSID Appellate Structure', (2006) 57 *Essays in Transnational Economic Law, Martin-Luther-Universität Halle-Wittenberg.*

66. *CMS v. Argentina*, Application for Annulment and Request for Stay of Enforcement of Arbitral Award of 8 September 2005. Cf. Article 52 of the ICSID Convention, providing for annulment of awards, *inter alia* if the tribunal 'manifestly exceeded its powers".

of similar ICSID cases pending against Argentina, it can only be hoped that the decision on annulment finds ways and means of healing the rift between the two decisions and shows the way forward for application of necessity in the financial realm.

The jurisdiction of the ICSID tribunals and their ability to substitute their own judgment for a country's economic policy choices, even in part, are tenuous. Whenever protection of foreign investors and policy flexibility clash, tribunals ought to exercise a good measure of judicial restraint, as municipal courts routinely do in similar circumstances. Overly broad restrictions on a government's room for policy manoeuvre will undermine the effectiveness and legitimacy of investment arbitration in the long run. Notwithstanding this, ICSID tribunals cannot and should not abandon their responsibility to protect foreign investors against government measures taken in violation of international law.

LG&E and *CMS* show that sovereign debt crises require a delicate balancing of the interests of private investors and the host country and its population. Whereas *CMS* risks unduly curtailing the government's policy space, *LG&E* might leave investors in precisely those situations where they need such protection most – in crises – without adequate international remedy. The solution to this dilemma is not obvious and requires further analysis. Curiously, in neither *CMS* nor *LG&E* was inability to pay invoked. Besides adapting necessity to the financial context, this is perhaps one direction in which international law ought to evolve.

Indeed, relying on the defence of lack of payment capacity seems in many ways more promising. The idea of an arbitral tribunal examining a country's financial resources is certainly not new.[67] Given the required methodological tools and with expert assistance, ICSID tribunals could determine a country's budget constraint. Necessity, a primitive defence, would be replaced by a rules-based examination of a country's payment capacity, hence there would be no need for an inherently subjective review of the adequacy of macroeconomic policy. This approach could combine extensive investor protection with due concern for genuine financial distress.

67. Early in the 20th century Wuarin laid out considerations for reorganizing the finances of defaulting states. The arbitrators would need to examine, *inter alia*, the economic conditions of the country and projected future economic developments, and its budgetary situation (A. Wuarin, *Essai sur les emprunts d'états et la protection des droits des porteurs de fonds d'états étrangers* (1907), at 128–9). Similarly, Sir Fischer Williams would require arbitrators to examine carefully the internal needs of the country (J. F. Williams, *Chapters on Current International Law* (1929), at 327–9).

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