The Emerging International Foreign Investment Regime: Implications for Host State Development Paths

Abstract

This paper examines the increasing use of bilateral investment treaties as instruments of foreign investment protection. The outcomes of treaty arbitrations are analysed to assess the extent to which treaties limit the economic policy choices available to host states. The disputes are also analysed to determine how such treaties may affect the development of legal institutions and the general application of a domestic rule of law. The paper uses a case study of Argentine treaty arbitrations at the International Centre for the Settlement of Investment Disputes. Argentina has been selected for its appearance in multiple disputes over the last decade. It is found that the awards from the disputes involving Argentina have for the most part severely restricted the host state from mobilising foreign-controlled resource sectors at a time of financial crisis. The disputes also show that the ratification of investment treaties appears to have played a part in diverting the development of effective regulatory mechanisms within the host-state's legal framework.

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1.1 INTRODUCTION

The influence of international capital, investors and investment facilitating institutions on the domestic capacity to control economic policy and develop internal institutions is not a new issue. However the rules that govern international capital have changed considerably over the last century, particularly in its last quarter. Prior to World War One, the age of empires saw many undeveloped regions of the world absorbed into the markets and more formal political institutions of the North Atlantic colonial powers. The protection of foreign investment in particular was more often than not secured by subjugation and the threat of force if encroached upon.[1] After World War Two, the political economy in the developing world was largely marked by struggles for independence and the creation of national, sovereign identities.[2] In more recent times, especially since the 1980s, developing nations have largely swung back to focus on economic growth and the means to achieve it. One way to achieve growth, which has clearly been the dominant path since the 1990s at the very least, involved pragmatic attempts to integrate less developed countries into the global economy and its engine in the North.[3] Many late industrialisers have seen a lack of capital as the principle problem impeding further growth and development. In order to attract capital they have looked to the North as a ready source of foreign direct investment (FDI). MNCs in the North have consequently invested heavily during the 1990s, especially in East Asia and Latin America. However FDI is not a source of capital the purpose for which is social and economic development. Stimulation of the economy, increasing competition, technology transfers and worker training may be consequences of FDI, but its primary objective is to convert investments into profitable returns. Thus the interests of the foreign investor and the host state are not co-aligned. How the tension between the protection of foreign investment property rights and the interests of host state is managed has been the subject of debate for some time. However the increasing recognition of international institutions to deal with it is a relatively new phenomenon,

[1] Spero and Hart 2003:268
[2] Minor 1994: 178
[3] Spero and Hart 2003: 267

which depending on the direction the institutions take, could have significant consequences for both MNCs and the host states in the developing world.

1.2 Aim and Scope of the Research

In this paper I examine the operation of operation of foreign investment protection on the host state as embodied in formal bilateral investment treaties (BITs). The purpose of BITs is mainly to provide treaty sanctioned protection for investments in undeveloped host states, with the intended aim of encouraging greater levels of inward FDI.[4] I have chosen to analyse the treaty effects on Argentina as a test case owing to its appearance in some 20% of all arbitrated claims for breaches of BITs lodged at the International Centre for the Settlement of Investment Disputes (ICSID).[5] The ISCID is an arbitration body which through its dispute resolution proceedings is a primary source for prescribing the scope and application of the bilateral investment treaty system.[6]. The primary data analysed are the awards made by the ISCID for cases following Argentina's 2001-2002 crisis. The questions I seek to answer could be put broadly as such;

What effect does the experience of international investment arbitration have on the sovereign rights of nations to regulate and manage their economies? How does this system impact on the development of the institutions necessary for the rule of law?

This raises several more specific questions. What reasoning does the ICSID give in making its decisions and what does this explain in terms of the property rights of foreign investors relative to domestic economic actors? To what extent does the BIT externalise the regulatory functions otherwise assumed by domestic institutions?

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[4] Sauvant 2008: 8
[5] www.worldbank.org/icsid
[6] Sauvant 2008: 13

From both a development studies and institutional economics perspective the rise of arbitrated foreign investment disputes within the framework of BITs is particularly relevant. While there has been a huge increase in FDI flows to developing countries over the last quarter of a century, there has been relatively little progress in the creation of formal multilateral institutions to accompany such an explosion of FDI. A brief comparison with the formalisation of rules on the conduct of trade and tariffs through such institutions as the GATT and the succeeding WTO exposes far less international agreement when it comes to multilateral foreign investment rules and regulations.[7] Analysis of this evolving regime provides clues as to the regulation of foreign capital and the relative status of foreign investors in less developed economies. The property rights granted to foreign investors under BITs and the extent to which the ICSID recognises the infringement of one may restrict the amount of policy freedom domestic governments have in situations of economic crisis, and more generally in the application of a development strategy.

By investigating the use of the ICSID and the outcomes of investor claims I also hope bring new insights into the implications BITs have for domestic rule of law development. The field of institutional economics generally deals with internal economic rules of behaviour. This study seeks to include the affects of external institutions in influencing the domestic process of institutional reform.

Some delimitations on the area of research are necessary. This paper does not seek to directly answer to what extent joining the BIT system attracts FDI flows to developing countries as my research involves a single country case study and therefore lacks a sample wide enough find any emerging pattern. It is assumed that the overall purpose for the host state agreeing to BITs was to either maintain or attract more levels of FDI.

[7] Spero and Hart 2003: 118

2. THEORETICAL CONTEXT AND PREVIOUS RESERACH

The protection of property rights for foreign investors occupies a curious place in the categorisation of social science theories. There are three dimensions to foreign investor property rights which entail different theoretical contexts. They are firstly governed by negotiation between the particular foreign investor and the host state, which entails a political-economy and game-theory approach. Secondly, due to the significant increase of foreign investment in the last 30 years, consideration for the rights of foreign investors forms part of the legal framework contained within the amorphously defined globalisation process. This aspect can be analysed with the use of a political economy approach as it is mainly deals with state to state treaty negotiation, which will have ultimate bearing on the development paths that states choose. Thirdly, the separation of foreign investor rights within a national economy from the property rights of all other internal actors affects the process of domestic institutional development. In this respect institutional economics is the primary theoretical vantage point. This paper focuses on the second two dimensions. However I present a discussion of the three theoretical frameworks below as there are significant overlaps between them.

With regard to foreign investments in the developing world, political economy theory has traditionally dominated most research. In the early 1970s Vernon articulated the model of 'obsolescing bargaining' to comprehend the power dynamics between Multi National Companies (MNCs) and host states[8]. Bargaining theory postulates a game between the host state and the MNC governed by their relative economic and political strengths and weaknesses. Host states in the developing world initially have a critical advantage over the MNC because they control access to their territory. The territory host states control appeals to MNCs for its internal markets, investment opportunities, local labour supplies and primary resources. Yet the MNC possess advantages which in many ways are far superior to the host state. MNCs are equipped with not only capital, technology and managerial skill but are integrated into global markets for which the developing host state desires for the purpose of economic development. MNCs in choosing where to invest in the world will be confronted by the problem of uncertainty

[8] Vernon 1971: 239-270

regarding the success and cost of the investment project. This uncertainty creates an asymmetry of power which grants the foreign investor an advantage at initial stages of investment. Developing host countries competing for limited global capital with many other states must establish conditions which are favourable to foreign investment such as relaxed regulation, lowering barriers to entry and the promise of legal protections for foreign investor property rights. However once the investment is made and it becomes economically viable, the uncertainty decreases and the bargaining advantage which the MNC had at first switches to the host state. Investments in fixed capital become sunk and in turn threatened by the host state's regulatory control over the investment once it is within the host state's jurisdiction. The host state thus is in a superior position to renegotiate contracts with the foreign investor.

Vernon's theory of obsolescing bargaining forms the political economy context in which to view the international foreign investment legal regime. International investment law, however, seeks to impose governance upon the treatment of foreign investment in the host state. International agreements on foreign investment thereby have a normative function in setting standards for the global movement of capital above and beyond the individual MNC to host state negotiation.[9] In this sense the regime is one of the emerging institutions of the globalisation project. Schneiderman argues that the architecture of rules and laws on investments at an international level performs constitution-like functions which check the exercise of local political authority on mobile forms of economic production[10]. In a related argument, Rodrick theorises that global trade and investment agreements, when ascribed to, can serve to limit the 'policy space' available to national governments.[11] International investment agreements can be understood therefore to limit the economic sovereignty of the host state. Treaties attempt to preserve and respect the sovereignty of member states, but at the same time their objective is to place constraints on domestic governments from legislating in favour of anti-trade and anti-global capital measures. Rodrick observes that such agreements are part of what he terms 'shallow integration' as opposed to

[9] Schneiderman 2006: 388
[10] Schneiderman 2006: 388
[11] Rodrick 2007: 3

'deep integration'.[12] Deep integration is characterised by an economic, political and legal unification through the elimination of jurisdictional discontinuities across national borders. The two prime examples are the United States and the European Union – both of which have generally allowed for free capital movement and free labour movement under democratic accountability. Ultimately this form of integration has eroded away the transaction costs related to the problem of sovereign self-determination. Rodrick defines 'shallow integration' to be attempts at integrating economies into a global economic system without the legal and political convergence, thereby leaving integration incomplete. The key problem for developing economies is that they are not able to deeply integrate with the richer Northern countries. They therefore face two options. One is the path of the 'development-state' with its associated industry policy models that puts forward a program of import substitution, subsidisation of tradables, the championing of national leaders and performance conditions for foreign investment. The other option is the liberalisation of the economy, limited government intervention, privatization and deregulation of state industries, reduction of trade barriers and free entry for foreign direct investment. Investment treaties are generally considered to form part of this second option.

The framework of international protections for foreign investment will ultimately have an influence on domestic institutional development. Because international treaties are law creating instruments, the identifiable institution to examine is the internal rule of law. Agreement on the importance of the development of a rule of law as a growth stimulating institution is fairly concrete; however agreement on where it originates and how it is defined is not. North argues that institutions advance economic growth by establishing constraints and incentives for human behaviour which in turn enables welfare enhancing exchange.[13] Institutions in particular serve as mechanisms to provide certainty of future performance in the event of non-simultaneous exchange.[14] Without any institutional framework, transaction costs are extremely high. Within North's bounded rationality, the role of legal institutions plays a significant role, particularly as it

[12] Rodrick 2007: 12
[13] Drobak, 1997: 8
[14] Dobrak 1997: 8

relates to property rights. Scholars such as De Soto argue that the strength of the rule of law is found within the substantive elements of law. De Soto finds that the formalisation of property rights in titling programs, property registration and contract enforcement mechanisms is the key to creating capital due to the security of exchange that such laws enable.[15] However opposing this argument are theorists who propose such universal substantive legal systems may be unsuitable for all social systems. Berkowitz, Pistor and Richard have found that transplanting existing substantive laws from developed states to other developing states has not been met with success.[16] The introduction of such laws, it is argued, can divert attention of law reformers away from the existing local informal rules and sanctions that bound human behaviour. On top of this, Pistor argues that the adoption of formal laws without adequate complementary institutions to provide for their enforcement, will not strengthen the rule of law principle. In the alternative, it is argued that the main objective of creating a rule of law is to impose constraints on the exercise of government power, rather than adopting substantive and particular legal regimes. In terms of reforming developing states, the objective here is to encourage widespread access to justice and encourage the establishment of independent judiciaries and regulatory authorities.

In the context of the debate over the rule of law, discussion has begun to emerge on the usefulness of international investment treaties such as the BIT in encouraging accountable legal institutions. Arguments have been developed that BITs serve to either encourage host states to adopt rule of law institutions or at the very least, BITs complement the existing institutions and encourage market-oriented policies. Reisman and Sloane highlight that BITs enable a stable, orderly framework for investment.[17] This argument is very much how governments in the developed capital-exporting states view the BIT program. US government policy on BITs is driven by the principle that "the...bilateral investment treaty (BIT) program helps protect private investment, develop market-oriented policies in partner countries, and promote U.S. exports".[18] Hallward-Dreiemer finds that BITs are more positive in promoting higher institutional

[15] De Soto 2000: 22
[16] Berkowitz 2003: 163
[17] Resiman and Sloane 2004:115
[18] http://www.ustr.gov/Trade_Agreements/BIT/Section_Index.html

quality, particularly with respect to the dispute resolution function of the treaties. The opportunity created in BITs to external arbitration, it is argued, may create a race to the top in adjudicating disputes impartially and fairly instead of a race to the bottom.[19] Investment arbitration can potentially fuel domestic support for the rule of law because it will instil an incipient belief in the capacity of institutions to administer justice impartially.

Ginsburg however argues that the impact of BITs on subsequent governance is ambiguous at best, and at worst it may lead to lower institutional quality in the years after a BIT is adopted.[20] He argues that the decision to bypass domestic courts may reduce courts' incentives to improve performance by depriving key actors from a need to invest in institutional improvement. Non-government organisations are also particularly critical of the BIT regime. Halle and Peterson from the International Institute for Sustainable Development argue that BITs grant foreign investors an 'escape clause' which reduces the incentives for them to encourage broader improvement of domestic institutions.[21] The remainder of research critical of BITs focuses on evidence that adoption of BITs does not lead to higher levels of FDI.[22]

[19] Hallward-Driemier 2003:21
[20] Ginsburg 2005: 122
[21] Halle and Peterson 2005:24
[22] Hallward-Driemier 2003:3

3. HISTORICAL BACKGROUND

3.1 Development of International Investment Agreements

The creation of international investment agreements must be understood in the context of the huge increase in both the amount and importance of FDI over the last 20 years. FDI has gone from a figure of around $50 billion during the early 1980s to approximately US$1.3 trillion at the end of 2006- with 70% now going to developing countries.[23] For these nations FDI serves to bring goods and services to foreign markets and to integrate national product systems. However, the methods and rules to balance protection of FDI with the regulation of FDI by host states has been and continues to be in a state of flux. Since the conclusion of World War Two, there have been efforts by the international community to agree upon the level and scope of protection afforded to FDI by host nations. So far these efforts have not been met with any conclusive multilateral agreement dealing with foreign investor treatment.

Relative to multilateral consensus over trade as defined by tariff policies, FDI governance is extremely limited and informal. A few articles of governance stand out, such as the Codes on the Liberalization of Capital Movements and of Current Invisible Operations, in which the OECD created some limited norms on non-discrimination between foreign and domestic investors within a country, freedom of establishment and freedom of funds transfer.[24] Other successes have been limited to the OECD countries, including the adoption in 1976 of the Declaration on International Investment and Multinational Enterprises which addressed general voluntary guidelines for MNCs operating abroad, formalised the notion of 'national treatment' to give MNCs equal treatment relative to domestic enterprises in host nations, and a pledge to remove conflicting legal and regulatory requirements on MNCs.[25]

[23] Sauvant 2008:4
[24] Spero and Hart 2003:155
[25] Spero and Hart 2003: 157

The broader effort, however, to set up a multilateral FDI governance system has been met with spectacular failures. Early attempts to solidify international agreements upon the freedom and control of FDI were seen with the creation of the Havana Charter in 1948, which sought to deal with the treatment of FDI (amongst other general rules on the conduct of trade).[26] Proposals by Latin American countries to establish national requirements for the ownership of existing and future FDI met with stern opposition by the US at the time, and subsequently the Charter was never adopted. In the late 1960s the most far reaching reform effort yet was initiated by the proposition of a General Agreement on Tariffs and Trade (GATT) dealing specifically with FDI.[27] The reforms sought to implement a series of international rules on the movement of FDI and to create a body regulating the operation of MNCs, however no concrete regulatory system emerged. In 1975, due to the influence of developing countries, the UN created the United Nations Commission on Transnational Corporations (UNTC), which sought to develop codes of conduct for MNCs (known today as the United Nations Conference on Trade and Development). UNCTAD serves largely only as a body monitoring FDI activities.[28] The World Trade Organisation (WTO) has some limited multilateral agreements on FDI for its members– the General Agreement on Trade in Services (GATS) and the Agreement on Trade Related Investment Measures (TRIMS).[29] The GATS is set up to ensure most-favoured nation treatment and transparency for services that are provided by foreign enterprises, while the TRIMS agreement is limited to issues related to trade in products produced by a foreign entity in the host state. However, the scope of these agreements is far from all-encompassing.

The last attempt to create a genuine multilateral order for FDI was proposed by 25 members of the OECD through the development of the Multilateral Agreement on Investment (MAI) in 1995.[30] Its purpose was to eliminate barriers to FDI and create forums for international investment dispute resolution. Largely due to the anti-globalisation

[26] Kenen 1999: 376
[27] Spero and Hart 2003: 157
[28] Spero and Hart 2003: 185
[29] Moltke 2004:13
[30] Spero and Hart 2003: 159

protest movement within developed countries of the late 1990s, the MAI was abandoned, and further multilateral agreements since then have failed to materialise.

4. THE FUNCTION OF BILATERAL INVESTMENT TREATIES

In place of a multilateral agreement on FDI, international investment is protected by law in a multilayered and multifaceted complex network of different international investment agreements.[31] Some of those protections are included in multilateral free trade agreements such as the North American Free Trade Agreement (NAFTA) and other similar trade treaties both bilateral and multilateral which contain chapters mandating the protection of foreign investment. Such trade agreements with provisions granting foreign investors international property protection are substitutes for investment matters not covered by the rules imposed by the World Trade Organisation.[32] However, by far the most common form of agreement governing FDI is represented by Bilateral Investment Treaties (BITs). The purpose of BITs is to encourage the spread of FDI and set standards as to the level of protection afforded to investments from one country to the other. In this sense they exist to fill the void on uncertainty over the applicability of international legal standards governing FDI in host states.[33] The first BIT was signed in 1959 between Germany and Pakistan, and they have steadily increased to the point at which by the end of 2006 there were some 2573 BITs in place.[34] Interestingly, despite the failure to come to an agreement on the MAI in the 1990s, that decade saw the numbers of BITs increase from 385 to 1,857.[35]

The function of the BIT is not necessarily to permit entry of FDI, but rather to provide protection for foreign investors operating in the sectors the host state has already decided to opened up to FDI (GGFDI: 7).[36] Despite there being a model BIT provided by the World Bank (ISCID), they are not all uniform. However they generally provide for the following standards:

Free Transfer of Funds

To allow the repatriation of profit, fees and interest from the host state.

[31] Sauvant 2008: 7
[32] Peterson 2005: 5
[33] IIA Monitor 2003: 21
[34] UNCTAD 2008: 1
[35] UNCTAD2008: 2
[36] Peterson 2005: 7

Limitations on Expropriation

To restrict the occurrence of direct or indirect expropriation of foreign-owned assets. Provided with this restriction is an agreement to pay fair and equitable compensation for any investment that is expropriated.

National Treatment

To provide for treatment of foreign investments (or investors) that is equal relative to the treatment given to domestic investments (or investors) in the host state.

Most Favoured Nation (MFN) Treatment

This means that the foreign investor cannot be accorded less rights than those granted to any other foreign investor from a third country

Fair and Equitable Treatment

This requirement provides for a minimum absolute protection of foreign investment which is not relative to the treatment accorded to domestic enterprises or other foreign investments.

In addition to these standards, most BITs include two important provisions. One is recourse to some forum for the settlement of investment disputes, usually the ICSID, and the other is to grant the foreign investor direct legal personality under international law.[37] The BIT gives the investor the right to sue the host government where host government actions are deemed to substantially expropriate the foreign investment.[38] The latter element of BITs is particularly unique and the most revolutionary when compared to other forms of treaties on trade, in that investors, as private actors, are entitled to bring claims for damages for breaches of the treaty against the host state (rather than the counter-party being the other contracting state, as would be the case

[37] Peterson 2005:8

[38] Hallward-Driemier 2003: 4

in the WTO system). Under most BITs the host state waives its right to sovereign immunity, the effect of which is to shift the dispute resolution system away from the host state's local courts and into the arena of external arbitration tribunals.[39]

Defining expropriation is one of the most significant issues for a BIT. BITs generally provide for legitimate expropriation only where it is lawful and compensation to the foreign investor is paid. The elements of justified expropriation depend on the BIT in question, however there are some generally held principles as to the definition. Foreign-owned property can only be expropriated where it is for a public purpose, it is carried out in a non-discriminatory manner, the expropriated foreign enterprise is compensated and the expropriation is conducted in accordance with due process of law.[40] The terms of compensation are the most controversial. The international legal standards have been defined as 'prompt, adequate and effective', 'payment of full value' or 'just compensation'.[41] Generally these terms have been expressed or interpreted as being a payment of full market value for the enterprise immediately before the expropriation took place. The definition of compensation therefore varies between BITs, with some ranging from clear market-value definitions to others being vaguely drafted, requiring legal adjudicators to give meaning to expropriation.

The key purpose of BITs is to protect foreign investment from expropriation from the host state. Where compensation in the event of expropriation would be at market value for the investment, there would theoretically be little disincentive to invest abroad as the investor would not bear any risk.[42] However even with full compensation, the host state may create a moral hazard problem where investments are expropriated in order to transfer resources to a favoured local actor.[43] The BIT aims to overcome this problem by making the expropriation of assets (with full compensation) only available for a public good rather than for a private gain.

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[39] Peterson 2005: 8
[40] Hallward-Driemier 2003: 5
[41] Hallward-Driemier 2003: 5
[42] Ginsburg 2005: 112
[43] Ginsburg 2005: 112

BITs offer reciprocal rights, in that each contracting state grants the same rights to a foreign investor from the counter-signing state.[44] However most BITs are between a developed country on the one hand, and a developing country on the other. Likewise, most FDI flows covered by BITs move from developed to developing countries.[45] There are very few OECD countries that have agreed upon BITs with other OECD countries – thus suggesting that where FDI flows are reciprocated, the states are less willing to grant foreign investor rights embodied in a BIT. Arguably the absence of BITs between OECD countries could also be due to the perception that there is no need to stimulate FDI in the developed country.[46]

4.1 Dispute Resolution for Bilateral Investment Treaties under the International Centre for the Settlement of Investment Disputes (ICSID)

The majority of BIT dispute resolution clauses defer to the ICSID. As an arbitration organisation it is affiliated with the World Bank, and as the preamble of the ICSID Convention states, the institution is concerned with "the need for international cooperation for economic development, and the role of private international investment therein" (ICSID Convention).[47] There are currently some 155 states who are signatories to the ICSID Convention, with 143 of them having fully ratified the Convention (ICSID website).[48] Although founded in 1966, it was not until the 1990s that the number of claims accelerated – coinciding with both the expansion of FDI and the number of existent BITs

The number of pending cases at the time of writing was 123. The following table breaks down the current investment claims by region:

WORLD REGION	NUMBER OF CASES

[44] Reisman & Sloane 2004: 116
[45] UNCTAD 2008: 2
[46] Hallward-Driemier 2003: 9
[47] ICSID Convention preamble http://icsid.worldbank.org/ICSID/ICSID/DocumentsMain.jsp
[48] ICSID List of Contracting States and Other Signatories to the Convention http://icsid.worldbank.org/ICSID/ICSID/DocumentsMain.jsp

Latin America	63
Former Soviet Republics	23
Asia and the Middle East	18
Africa	14
Others	5

Source: ICSID

Latin America is well represented, representing half of the case load. More striking is that Argentina appears as a respondent in 34 of those claims (ISCID website).

5. RESEARCH METHOD

This research takes the form of a qualitative case study using Argentine arbitrated awards as the main dataset. I intend to examine the claims to find out both the policy implications of BITs and the way in which foreign investments were made in the host country. This data can explain when and how the investments were made and what the relationship to regulatory authorities was like. The focus on outcomes from a limited number of investment arbitrations faces several stumbling blocks for the purpose of making comparisons amongst different countries. Because the allocation of awards per country is not equal or proportional, it is difficult to provide a control mechanism. Hakim states that for exploratory research where there are little prior investigations, it may be defined as a descriptive case study.[49] I hesitate to label this a descriptive case study as I hope to draw deeper linkages between international institutions and the domestic economy. However given the limitations in data there are evidently several drawbacks in making conclusive cause and effect determinations.

By analyzing the claims it is possible to get an insight into the relationship between foreign investors and host states. The legal reasoning of the tribunal also presents the process by which the BIT policy is determined. The decisions on investor claims have considerable reliability in that the evidence is reported in great detail for the purpose of establish legal arguments. The points on which parties agree can be isolated.

As already discussed there is no one body or standard convention designed to govern the protection of foreign investments- the sources of international law governing FDI and the forums nominated for dispute resolution can be found within regional trade agreements such as NAFTA or within the thousands of BITs successfully negotiated. However it is increasingly the case that the ICSID is the nominated investment dispute forum within the rules of BITs. Thus it is necessary, and desirable, to limit research to this body as it stands out as the most visible institution aiming to resolve questions of foreign investment protection.

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[49] Hakim 2000: 59

The primary materials for my research are both the caseload and the outcomes of disputes decided by the ICSID. As a representation of the current international investment protection regime, there are some qualifications as to the reliability of using ICSID outcomes. Outcomes are particularly difficult to come by for two reasons. First, arbitration at the ICSID is a relatively new phenomenon in the sense that it is only within the last decade that the number of cases has exploded, and given the time consuming nature of legal disputes, the awards decided so far are few. Secondly, the publication of ICSID awards must be consented to by both parties. Hence not all awards are publicly available. However, the ICSID is more transparent than most international arbitration bodies in that it must publically register all claims and encourages as much publication as possible on the decisions contained within awards.[50]

Given the constraints operating on this exercise, I have selected to conduct a qualitative case study of Argentina's experience with BITs and the ICSID in the period from 1990 to 2007. Argentina stands out as having the highest number of investor claims both decided and pending. The claims examined are very recent, all commenced since the turn of the millennium. It is also evident that the majority of claims against Argentina stem from similar kinds of disputes. It is therefore obvious that any conclusions will relate to the specific circumstances of Argentina's recent economic history. However the importance of ICSID decisions relating to Argentina should not be underestimated. They present the most recent examples of modern day state-investor disputes and carry weight in setting precedents for foreign investment treaty law and international customary law.

5.1 The Data

For the full caseload, investor parties, host states and disputed matters at the ICSID, I have attained the data from the ICSID website. Similarly the substantive awards researched which pertain to Argentina have been downloaded from the ICSID. These awards have been selected as they are the first in Argentina to be decided on the merits relating to the 2001-2002 crisis (i.e. the decisions clarify the ICSID's opinion as to

[50] UNCTAD 2008:1

the substantive level of protection owed to foreign investments rather than decisions pertaining to procedural matters). They are also claims which arise on the basis of the BIT agreed between Argentina and the US. The transcripts of the awards are available on the ICSID website[51]. The claims are listed as

- CMS Gas Transmission Company v Argentina (CMS) Award rendered on May 12, 2005
- Enron Corporation and Ponderosa Assets LP v Argentina (Enron) Award rendered on May 22, 2007
- LG&E Energy Corp and ors v Argentina (LG&E) Award rendered on July 25, 2007
- Sempra Energy International v Argentina (Sempra) Award rendered on September 28, 2007

[51] http://icsid.worldbank.org/ICSID/FrontServlet

6. FINDINGS

6.1 Origin of the foreign investor claims with Argentina as the Host State

At the end of 2001 Argentina experienced one of the most severe financial collapses in its history. Unemployment skyrocketed, and about half the population dropped below the poverty line. As the value of the peso dropped, the country experienced massive capital flight. In one day alone some 30 people died amid rioting in December 2001.[52] Amid the chaos the government changed presidents five times within only 10 days.[53] The government eventually defaulted on $155 billion dollars of public debt, the largest sovereign default in history.[54]

In response, the economic priority of the government was immediate stabilisation of the economy and a restoration of political order. One of the dramatic policy reversals was the dissolution of the currency board and the effective ending of the 'convertibility plan' which had been in place since April 1991.[55] The convertability plan had sought to stabilize the economy and avoid hyperinflation by tying the peso at a one-to-one ratio with the US dollar.[56] The end of convertability saw a drop in the value of the peso to one third of the US dollar. All financial instruments and obligations were 'pesofied' and all bank account withdrawals were frozen through a number of different policy measures. These measures combined imposed a drastic cost on all actors in the economy, both domestically owned and foreign. Local firms and the general community had little recourse to recover moneys lost owing to the policy measures, however the foreign investors sought protection under the regime of BITs which Argentina had agreed upon, mostly dating from the 1990s.

6.2 The Foreign Investor Claims

[52] The Economist 2002: 27
[53] The Economist 2002:27
[54] The Economist 2002:27
[55] Haslam 2003: 2
[56] Haslam 2003: 3

The four awards examined have similar properties and essentially the same claim. They all related to gas supply – two of which are gas distribution (Sempra and LG&E) and two of which are natural gas transport (CMS and Enron). The claims all related to breaches of the US-Argentina BIT which was ratified in 1994. As all claimants were foreign investors domiciled in the US they were granted jurisdiction to make a claim. The contended issues stem from the policies Argentina took in initially freezing price adjustments in the US producer price index (PPI) in January of 2000, and then later with regard to the pesofication of the previously contractually agreed (through the licensing terms) of the dollar denominated tariffs without adjusting the tariffs levels. The regulator responsible for the tariff regime was ENARGAS, however the full freezing of tariffs and conversion of contracts into pesos was initiated by the executive under the Emergency Law 25.561.[57] The investments involved were partly financed by dollar denominated loans, which given the sudden drop in value of the peso, led to a massive decline in profits due to the servicing of the external debt.

6.3 ICSID's Decisions on Expropriation and Fair and Equitable Treatment

For all four claims, the investors sought compensation for breach of the BIT under both the expropriation clause and the fair and equitable treatment clause.[58] No claim was brought for a breach of national treatment – suggesting that the investors did not consider themselves have been given worse treatment than that accorded to domestic investors.

The tribunals found that the claims for expropriation, or 'creeping expropriation' were inapplicable as the state had not formally assumed direct control over the property in question.[59] However for all cases, the tribunal found a breach of fair and equitable treatment, defined in the US-Argentina BIT under Article II(2)(a) as "investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by

[57] Sempra at 116
[58] Sempra at 95, Enron at 87, LG&E at 72 and CMS at 88
[59] Sempra at 286, Enron at 200 LG&E at 265, CMS at 283

international law".[60] The BIT did not define the standard of fair and equitable treatment, and thus it was left to be interpreted by the tribunal. In CMS the tribunal sought assistance interpreting its meaning by referencing the preamble of the BIT which "envisaged..that fair and equitable treatment is desirable to maintain a stable framework for investments and maximum effective use of economic resources. There can be no doubt, therefore, that a stable legal and business environment is an essential element of fair and equitable treatment".[61] The emergency measures adopted by Argentina were found to "entirely transform and alter the legal and business environment under which the investment was decided and made".[62] Argentina argued that there would have to be an element of bad faith in enacting the currency devaluation, however, the tribunals decided that a stable legal and business environment was an objective requirement not tied to the intentions of the state.[63]

The decisions to find in favour of a breach of the fair and equitable treatment requirement is set in the context of a 'minimum standard of treatment'. The minimum as defined by the tribunal is a stable legal and business environment – the emergency policies of devaluation and freezing tariff adjustment are destabilising actions irrespective of whether they were enacted to prevent further expansion of the crisis. It is not necessary that deliberate or even mildly self-serving political action to deprive foreign investors of profits be shown.

6.4 Argentina's Plea of Defence for Breaches of the BIT

Argentina denied its policy actions caused the damages for which the investors claimed. The defence rested essentially on two different arguments. The first was that the 'non-precluded measures' (NPM) clause of US-Argentine treaty gave Argentina sufficient space to act in an emergency that did not contravene its obligations to the protected foreign investments. The second defence was that irrespective of the treaty clauses, the principle of a 'state of necessity' in customary international law trumped

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[60] http://tcc.export.gov/Trade_Agreements/Bilateral_Investment_Treaties/index.asp
[61] CMS at 274
[62] CMS at 275
[63] CMS at 280

the treaty protections. This second argument was also based on a legal right of the state to take policy measures in the state of an emergency which precluded harm towards foreign investors. How the ICSID judged Argentina's defences determined the extent to which the BIT protected foreign investments.

The scope of Argentina's BIT with the US contains a clause for NPMs which limits investor protection in extraordinary circumstances. The NPM clause allows the state to take action otherwise inconsistent with the treaty where 'actions are necessary for the protection of essential security, the maintenance of public order, or to respond to a public health emergency'.[64] This clause is the only one identifiable which grants states to ability to act contrary to the property interests of foreign investors. There is no wider clause relating to social and economic obligations of the host state to its citizens that would allow for contravention of the BIT. If host-state policy is taken which falls under one of the NPM criteria, the host-state should be free from liability under the BIT. Argentina argued that the economic collapse of 2001 triggered the NPM clause and therefore relieved the nation of liability under the BIT.[65] The policy decisions the state took were put forward as being necessary for the protection of security and public order. Argentina also argued that the host-state should be able to judge for itself what constitutes an exceptional circumstance for the protection of public order- meaning in legal terms that the use of the NPM clause is 'self-judging'.

The doctrine of 'necessity' affords a state room to take actions that "safeguard an essential interest against a grave and imminent peril".[66] Hence, the applicability of this doctrine precludes a state from liability for failure to protect foreign investments. Argentina has argued that the policy measures taken for macroeconomic stabilisation in 2001-2002 were the only available options it had. Bringing up the defence of necessity was separate from the defence invoking the NPM clauses, as its legal origin was from international customary law rather than the BIT, however they are related arguments. Furthermore, like the use of the NPM clauses, this is the first known time of

[64] US-Argentina BIT Article XI
[65] CMS at 332, Sempra 325, Enron at 93, LG&E at 201
[66] CMS at 316

using necessity as a defence in investor-state disputes. The outcomes of the cases thus determine the level of flexibility states are granted under the investor protection regime in times of crisis.

From the four cases invoking the NPM and necessity defences, the ICSID has rejected Argentina's argument in three of them. In CMS v Argentina, Enron v. Argentina and Sempra v. Argentina the ICSID denied the applicability of the defences. Only in LG&E v. Argentina did the tribunal find that the NPM clause applied, but did not make a ruling on necessity. Thus, firstly, the ICSID has so far found that in a majority of the cases there is no recourse for Argentina to plead these defences. Secondly, due to the LG&E case finding applicability of the NPM clause, there is a conflicting decision on a set of facts virtually identical to the other decided cases. Following these awards, remaining numerous pending cases thus face the either an unfavorable ICSID view on the justness of Argentina crafting emergency legislation, or they face a problem of unpredictability of the tribunals decision making.

6.5 The Tribunals' decisions on the NPM clause and Necessity

The interpretation in each of the cases regarding the NPM clause were slightly different, however they had two common outcomes. While on the one hand the tribunals found that ''security and public order' (Article XI of the US-Argentina BIT) provisions of the US-Argentina BIT were broad enough to include economic emergencies, they decided that use of the NPM clause of the BITs was not a judgement Argentina could make subjectively for itself. The decisions of CMS, Enron and Sempra followed a common reasoning, applying a very strict standard to the NPM clause. The tribunals required Argentina to show the actions it took were the only available to the government to respond to the crisis. LG&E took a different approach which afforded a margin of appreciation (taking account of the state's unique social, economic and political systems), according to which an international tribunal will allow discretion to the state itself to design economic policies within a margin of international supervision. Thus in

LG&E the tribunal granted Argentina a wider policy space in which to make a determination of the appropriate response to the crisis.

"the conditions in Argentina in December 2001 called for immediate decisive action to restore civil order and stop the economic decline...Article XI (NPM clause) 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."[67]

Hence from LG&E the policy judgement on crisis management rested with host state, rather than confirming the existence of an implicit authority in the BIT granting the ICSID power to review policy decisions. The tribunal considered the social and economic obligations of Argentina to be greater than the property protections owed to the foreign investors. In contrast, the decisions from the CMS, Enron and Sempra severely restricted the applicability of the NPM clause to Argentina's circumstances during the crisis.

In each of the cases the tribunal gave an opinion on the applicability of the defence of necessity. As with the decisions on the NPM clause, LG&E was the exception. CMS, Enron and Sempra found that the defence was inapplicable and therefore the wrongfulness of Argentina's actions was not precluded. LG&E found that the defence might be available (it ruled that the NPM defence was sufficient, and thus did not make a decision on necessity). In deciding the application of necessity in times of crisis, the tribunal looked to the International Law Commission (ILC) Draft Articles on the Responsibility of States for Internationally Wrongful Acts which state:

> "1. Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international

[67] LG&E at 239

obligation of that State unless the act: (a) Is the only way for the state to safeguard an essential interest against a grave and imminent peril; and (b) Does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole. 2. In any case, necessity may not be invoked by a State as a ground for precluding wrongfulness if: (a) The international obligation in question excludes the possibility of invoking necessity; or (b) The State has contributed to the situation of necessity. [68]

All tribunals accepted the Draft Articles as the providing the definition of the necessity defence in customary law, and used it as a benchmark to determine Argentina's position.

CMS, Enron and Sempra all interpreted the definition so narrowly that they excluded the defence of necessity in Argentina's crisis- thus making state economic decisions to alleviate an emergency outside of the scope of the Draft Articles. They found that the economic crisis was not dramatic enough to threaten Argentina's essential interests.

> The CMS tribunal notes: "The Tribunal is convinced the crisis was indeed severe...However, neither could it be held that wrongfulness should be precluded as a matter of course under the circumstances" .[69]
> In Enron the Tribunal found: "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" [70]

In LG&E the economic crisis was sufficient enough to imperil and essential interest and therefore the defence of necessity could be argued "As evidence demonstrates, economic, financial or those interest related to the protection of the State against any

[68] http://untreaty.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf)
[69] CMS at 320
[70] Enron at 306

danger seriously compromising its internal or external situation, are also considered essential interests"[71] (LG&E Decision on Liability, note 33, at 251)

The second issue on necessity considered by all four of the tribunals was related to the Draft Articles section 25 1.(a) where a government act "is the only way for the state to safeguard an essential interest against a grave and imminent peril". The ILC Commentaries to the Draft Articles provide that "the plea is excluded if there are other (otherwise lawful) means available, even if they may be more costly or less convenient".[72] The tribunals were required to interpret what the 'other means available meant'. They were in effect deciding if the defence of necessity could be invalidated if, on the one hand, Argentina could have generally taken a different policy choice, or on the other hand, the defence could only be invalidated if an equally effective policy choice could be shown to have been available that would not have breached the duty owed to protect the foreign investment. Thus the tribunal was deciding how much room they should give to Argentina on allowing the state to decide that its policy choice was the only or best available response to the crisis.

CMS, Enron and Sempra all came to similar conclusions that it was possible that there was some other policy means available to Argentina to address the crisis, without explaining what that policy might be. In Sempra it was found that

> "While one or the other party would like the Tribunal to point out which alternative was recommendable, it is not the task of the Tribunal to substitute its view for the Government's choice between economic options. It is instead the Tribunal's duty only to determine whether the choice made was the only one available, and this does not appear to have been the case."73

The three tribunals therefore assumed that there was some alternative policy choice that Argentina could have taken without actually deciding if the alternative choices

[71] LG&E at 251
[72] CMS at 324
[73] Sempra at 351

would have been as effective in dealing with the crisis. The tribunals therefore excluded Argentina from the process of deciding whether the policy choices were effective.

Finally for the defence of necessity, the Tribunals all considered whether Argentina's economic policies contributed to the crisis, which if shown to be true, would invalidate the defence of necessity. The tribunals considered the 'level' of contribution to the crisis. CMS, Enron and Sempra found that any contribution by Argentina at all to the crisis was sufficient to invalidate the necessity defence. This included contributions that stemmed from past government economic planning.

> In Sempra the tribunal found "…therefore (it) cannot be claimed that the burden falls entirely on exogenous factors. This state of affairs has not been the making of a particular administration, given that it was a problem which had been compounding its effects for a decade. Still, the State must answer for it as a whole"[74]

The implication from the tribunals was that the policy formulation of the decades before the crisis were incorrect to the extent that it would be disciplined by the tribunal – in this way the tribunal was asserting a broader judgement as to the efficacy of economic policies and planning and found it to be out of line with an expected policy conducive to foreign investment, irrespective of whether harm to foreign investors was intentional or not.

In terms of the damages awarded, in Sempra, Enron and CMS the claimants were awarded US$128 million, US$106 million and US$149 million respectively.[75] In LG&E although the tribunal found that Argentina was in a state of emergency and thus satisfied the NPM clause, this was only taken to be for a temporary period. The Tribunal still awarded the claimant US$57 million.[76]

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[74] Sempra at 354
[75] Enron p.138, Sempra p.137, CMS p.139
[76] LG&E 'Award' at 115

7 ANALYSIS AND DISCUSSION

The cases presented here are the first to be decided which have their roots in the Argentine crisis of 2001-2002. Moreover, for the ICSID there has not been a caseload level emanating from a single state with such similar issues at stake. It should be noted that while there is little the ICSID or the successful foreign investors can do to enforce the decisions beyond the intervention of the claimants' states, there are serious reputational effects of non-compliance as well as the accumulation of further outstanding liabilities in damages. These claims are the first of many that have been lodged since the crisis, with possibly more still to come. Below I discuss the implications for the decisions made in CMS, Enron, Sempra and LG&E for the development of a set of externally sanctioned property rights immune and separate from the domestic Argentine legal system. While it is difficult to identify cause and effect between case outcomes and policy making, the decisions as outcomes from international legal proceedings do apply retrospective judgment on the domestic policy decisions made at the time of the crisis. It is possible to identify two qualified inferences arising from the decisions. One is that the BIT, of the nature negotiated between Argentina and the US, carries with it a policy-disciplining function not described within the treaty itself but interpreted by the tribunals in the act of making a decision. The other is that the BIT system, by creating special rights to foreign investors of external dispute resolution, bypasses the legal system of the host state and implicitly denies mutual accountability between the foreign investor and the domestic institutions for justice. Given the multitude of claims seeking ICSID arbitration rather than through the domestic courts, this may be leading to a fracturing of the application and breadth of the internal rule of law. In the case of Argentina, this issue is separate and above whether or not the state's policies were justified. It is a question of whether the claimant's reliance and use of the BIT undermines the development of domestic regulatory and legal institutions needed for modern economic growth.

7.1 The ICSID awards and Policy Space

One initial consequence of the awards from the above cases is they set a fairly strict precedent which serves to limit the policy choices available to the host-state in times of crisis. To get a better picture of what is at stake in the ICSID's decisions, it is first important to provide the wider context of FDI in Argentina and the number of pending claims lodged at the Tribunal. In the case of Argentina, the magnitude of policy constraints coming from the decisions is potentially quite damaging given overall amount of FDI which is covered by BITs. From 1992-2002 there was a total FDI inflow to Argentina of US$77 billion (FDI and Sustainable Development).[77] The following countries all have negotiated BITs with Argentina, and they form the majority of all FDI originating countries into Argentina during this period:

Country	Amount of FDI as a total % of all FDI 1992-2002
Spain	37.7
US	22.9
France	9.3
Chile	4
Italy	4
The Netherlands	3.8
Germany	2.3
UK	1.9

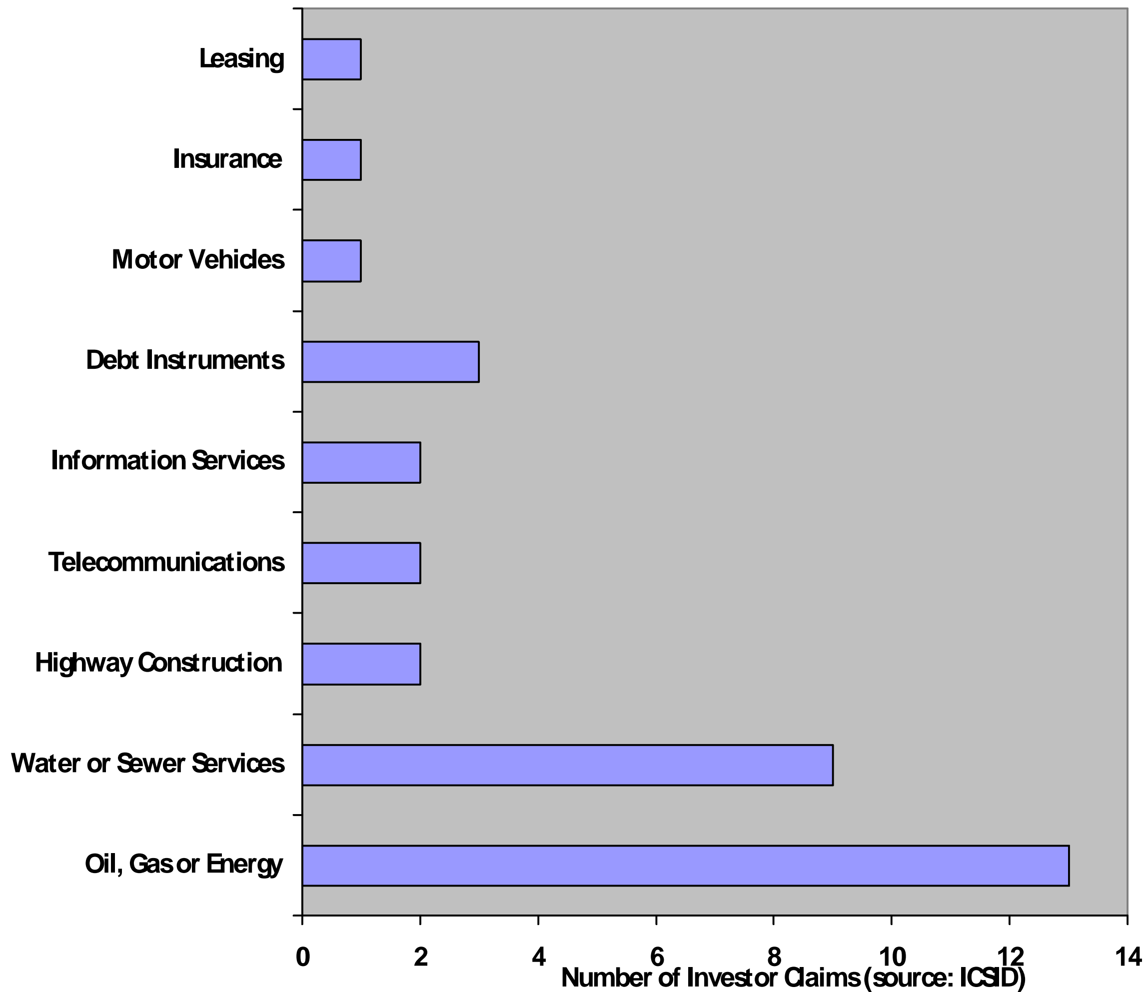
Notably, these FDI inflows were associated with Argentina's liberalization program of the 1990s. During the first half of the 1990s, inflows were mainly attracted by the privatization program initiated by the first Menem administration (1989-1995). [78] This included the investors represented in the CMS, Sempra, Enron and LG&E claims, which related to the privatization of the formerly state-owned gas transport and gas distribution industry.

[77] Bouzas 2004:8
[78] Bouzas 2004:5

Aside from the potential amount of foreign investments covered by BITs, the actual numbers of claims and total damages demanded already are high. It is estimated that the total value of the compensation sought for claims against Argentina stands at US$20 billion, equivalent to 11% of Argentina's GDP (The Economist).[79] Given the awards so far have tended to be against Argentina, it is clear that the cumulative effect of such a large number of pending claims is a serious problem for Argentina's government. The claims do not represent isolated incidents of mistreatment of foreign investment. The majority of claims are related in some way to the governments handling of the crisis over 2001-2002, or in the period immediately prior to the crisis.[80] The importance of the ICSID's awards for the ability to make economic policy and regulate in times of crisis can be garnered from the fact that foreign investors in large numbers evidently see some chance of winning in a claim for breaches of BITs. The diagram below splits the claims up according to the industrial sector:

[79] The Economist 2005

[80] The Economist 2005



As can be seen, utility related investments form the basis for the majority of the claims. They were an industry most affected by the freezing of energy tariff rates and the pesofication of contracts.[81]

Given such high levels of FDI for Argentina in the 1990s and the emergence of ISCID arbitration as a forum of choice for aggrieved foreign investors it is clear that the outcomes of the claims based on BIT breaches carry weight as policy-limiting devices. However they operate to limit policy in a way which is quite unique and particularly ad-hoc in comparison to other treaty-based policy restricting measures. Unlike trade

[81] Mortimore 2006:21

related agreements of the WTO such as the TRIMS, TRIPS and GATS agreements, the BITs are rarely specific on which sectors of the economy and in what circumstances investments are afforded protection. The TRIPS agreement, for example, covers protection of trademarks, copyrights, industrial designs, data secrets, and patents (on drugs, electronic and mechanical devices).[82] As far as dispute settlement goes, the TRIPS agreement specifies the rights and obligations of developed and developing countries and the situation in which a country may lodge a claim.[83] It is also the fact that under these types of trade agreements, it is the nation-states which lodge and settle claims, rather than a hybrid of investor to state dispute resolution. The outcomes of the cases presented in this paper are therefore clarifications, based upon interpretations of vaguely drafted clauses, of the full significance of BITs for host state policy options. The policy implication of agreeing to the BIT from these cases is that host-states relinquish their ability to control price-setting in vital foreign owned utility sectors during times of crisis. Yet this extends beyond 'emergency periods', as in the case of Argentina, the dissolution of the currency board was a policy which acted to fundamentally restructure the macro economy, and is likely to remain permanent. It is therefore more than a short-lived set back for foreign investors, and it is evident many of them are seeking to recoup losses which relate to a seismic shift in monetary policy at the very least.

It may seem inappropriate to suggest that Argentina relinquished its ability to set price-controls on energy and resources operated partly by foreign shareholders. The unfavorable awards in the analyzed cases operate to limit policy ex post as they are interpretations to give meaning to unclear treaties. However, while they do not operate to reverse economic and social legislation in Argentina, the effect in awarding compensation owing to the application of the 'wrong' policy by the host-state is, at least in a legal sense, tantamount to a domestic constitutional court striking down unlawful legislation. The wider implication for developing countries with BIT protected foreign investment is that the ICSID, in the case of Argentina, did not make a decision (with the exception of LG&E) which accounted for the social and economic rights of

[82] Wade 2003: 623
[83] Wade 2003:623

the general population. The US-Argentina BIT does not provide for any such rights, save for the operation of non-precluded measures, of which only the LG&E decision gave effect. Equally the awards dismissed the applicability of the international customary principle of necessity. Thus in CMS, Sempra and Enron the ICSID interpreted the BIT as giving rise to what is a form of strict liability in the situation of an economic crisis. The effect of the BIT, particularly relevant from a commercial or political-economy view, is to transfer the risk of economic meltdown from the foreign investor to the host-state. The BIT fixes this by providing for an obligation of 'fair and equitable treatment', which as the cases have identified means ensuring the fulfillment of the foreign investor's expectation of a 'stable business and legal environment'. For developing countries, particularly those historically susceptible to periods of crisis such as Argentina, such expectations are difficult to ensure. However based on the awards, the BIT operates to give a guarantee of stability. Rather than a breach arising from the uncompensated expropriation of foreign investment, as was the traditional issue at stake for foreign investment protection, the successful reliance on fair and equitable treatment implies the minimum standard guaranteed by the host-state is a form of macroeconomic stability.

To illustrate from the case of CMS the way in which this guarantee is interpreted, it is useful to look at the arguments of the claimant for which the Tribunal found in favour. The claimant in CMS explained that it decided to undertake the important investments in the gas transportation sector in reliance on the Argentine Government's promises and guarantees, particularly those that offered a real return in dollar terms and the adjustment of tariffs according to the changes in the US Producer Price Index.[84] The claimant argued that its ability to pay its debt had been reduced by a factor of more than three because the debt is denominated in US dollars and there has been an intervening devaluation of the peso.[85] The claimant also argued that "the broader economic implications of the Emergency Law have led to an artificial depression of consumer gas prices in Argentina, particularly as a result of the tariff freeze. Because Argentine gas prices are among the lowest in the world, an effective subsidy benefiting

[84] CMS at 68
[85] CMS at 69

the rest of the Argentine economy has had a negative impact on the regulated gas sector, amounting to several billion dollars for the energy sector as a whole".[86] In contractual terms, the claimant did have a guarantee under its gas license that tariffs for transportation should be calculated in dollars and they relied upon the tender offer articles of the Privitisation Committee which stipulated that "the tariffs are in dollars and expressed in convertible pesos, for which reason, when faced with an eventual modification of the Convertibility Law, they should be automatically re-expressed at the modified rate".[87] Argentina argued that part of the loss CMS claims is the fault of CMS for using debt financing, and in particular using dollar denominated debt from the US rather than Argentine debt which would have been affected by the devaluation.[88] CMS chose dollar debt, and therefore it chose the riskiest option. The investment prospectus prepared by the Board of TGN, for which CMS bought a 29% share, warned of potential adverse effects of a devaluation on revenues – "In case of a big devaluation of the peso in respect of the dollar, the patrimonial situation and the operational results of the Company could be adversely affected, as would also be the case of the capacity to make payments in foreign currency (including the repayment of debt expressed in foreign currency) and the distribution of dividends in dollars at acceptable levels".[89] Argentina argued that under the Gas Law, transportation and distribution of gas is a national public service which must take into account particular needs of social importance. It was further argued that no commitments could have been made by Argentina to maintain a certain economic or exchange rate policy and that the State should be free "to change such policies, a right which cannot be subject to claims by individuals or corporations".[90] Argentina was characterized by an unstable economy, the tariffs took into account the added risk of investing in that country and were therefore higher than would normally have been the case: "Had the tariffs been adjusted by 300% as CMS would have wanted, public services would have been

[86] CMS at 72
[87] CMS at 135
[88] CMS at 24
[89] CMS at 93
[90] CMS at94

paralyzed, the incomes of the licensees would have dramatically decreased and public reaction would have been beyond control".[91]

The Tribunal decided that the claimant had a right to tariff adjustment by reference to the privatization program and the expectations of stability that were represented in the tender offerings; "in the context of the privatization it was abundantly clear that one of the key elements in attracting foreign investment and in overcoming the economic and financial crisis of the late 1980s was to provide the necessary stability. Declarations by public officials repeatedly confirmed this understanding and the Memorandum, while not legally binding, accurately reflects the views and intentions of the Government. This very same understanding…was expressly confirmed by the Privatization Committee, a step that must be considered as having some legal implications".[92] Thus the Tribunal decided that the contractual obligation to provide for tariff stability was related to a requirement to provide for a stable foreign investment climate. The contractual obligations of the host-state do not cease to be enforceable in the event of a complete change in the economic realities. In turn, the fair and equitable treatment principle of the BIT obliges the state to be strictly liable for instability and automatically pass the risk of such instability on to the host state.

On the question of compromising state capacity to make policy, the outcomes from these cases, qualified by the different decision in LG&E, create two sets of problems emanating from the BIT order, with the second being most problematic. The first is that the BIT provisions for fair and equitable treatment effectively freeze the property rights of foreign investors relative to declining rights of the host state domestic actors in a time of crisis. Ignoring the position of foreign investors, where currency devaluation affects the value of all contracts in a non-discriminatory way, property rights themselves are not necessarily changed by virtue of the fact that the collective income of the whole country has dropped. However as the BIT is interpreted to guarantee that the contractual rights of foreign investors cannot be disqualified by an absolute and sudden decrease in economic returns, foreign investments covered by BITs have in fact

[91] CMS at 97
[92] CMS at 135

positively increased their property rights relative to all other domestic actors. The domestic actors, which include all local firms have no recourse to the same remedy that BIT covered foreign investors can seek. If they could successfully do so, or likewise in the opposite situation where the foreign investor successfully sought compensation through the host-state's legal institutions as an equal to aggrieved domestic actors, the net gain based solely on losses due to pesofication would be nil for all. The second problem is that the Tribunals, by translating to the BIT provisions of fair and equitable as meaning a stable 'legal and business environment', effectively lock-in policy choices on behalf of the host-state so that drastic restructuring, such as a monetary policy turn around, are not possible without incurring massive liability. In the case of Argentina, the problem of peso parity with the dollar was an unsustainable policy given the contracting monetary supply towards the end of the last century. Ironically the convertibility law was associated with the same neoliberal program which included the ratification of BITs with capital exporting states and a raft of other trade-related measures in line with the Washington Consensus. The outcomes of the claims regarding Argentina appear to favour foreign investors to such an extent that to logically follow the obligations the BIT placed on Argentina, which implicitly mean maintaining the dollar-denominated tariffs, would be an economic and political impossibility.

The transfer of the risk of macro instability from the investor to the host state creates hazards for future economic development policy. In the pursuit of FDI, the awards in this case study suggest that Argentina had guaranteed the expected returns of the privatized foreign-owned utility companies against sovereign risk through the conclusion of BITs, although this was not clear from the treaty. The non-precluded measures which provided an undefined safeguard against the assumption of the risk were found only to apply in LG&E. The more host-state friendly outcome of this particular decision which envisaged the application of a margin of appreciation for the operation of undefined NPM clauses provided more room in which the state can exercise policy. In this interpretation, the Tribunal found that the relative development level of Argentina could be considered in defining the meaning of the NPM of 'actions are necessary for the protection of essential security, the maintenance of public order, or to respond to a

public health emergency'.[93] Thus for Argentina protection of essential security and maintenance of public order could cover actions to mitigate an unfolding financial crisis, which might include policies which would be considered excessive by the standards applied to developed countries facing a crisis situation.

The decision of LG&E is however the exception in the cases examined. The decisions in CMS, Sempra, and Enron freed the foreign investors from the risk of devaluation. As all the investors attributed their losses in connection with loans sourced from abroad in dollar denominations, they had clearly financed their operations with a large degree of risk. The more stable option would have been to raise finance from Argentine capital markets. One of the implications from this is that the BIT, by guaranteeing host-state assumption of currency risk, relieves the constraint on foreign investors to use the local capital market. Although financial instruments in Argentina would have been less developed and sophisticated than their North American counterparts, the avoidance of financing infrastructure investments locally further marginalises the development of internal capital markets. It is worthwhile noting that Brazil, which has no ratified BITs in place, has seen private investors finance infrastructure projects through the local financial markets.[94]

One further consequence of the BIT regime for local firms is that there is a distinction in the treatment between foreign and domestic investors within the same country for protection from expropriation. The domestic investor cannot seek a remedy from an external decision-maker such as the ICSID, while foreign investors covered by a BIT are able to do so. However as the case of Argentina demonstrates, in the event that foreign investors are accorded greater rights to compensation through the arbitration of the ICSID as they have been with respect to currency devaluation, the domestic legal system offers less protection for property rights for domestic investors. Differential treatment thereby creates additional barriers for domestically owned and incorporated firms within the developing country. The net effect is that they are put at a competitive disadvantage. Continuing arbitration and the resultant differentiation of treatment

[93] US-Argentina BIT Article XI
[94] Darche 200: 13

leaves domestic firms to operate in a sub-standard legal and property protection regime.

7.2 BITs And the Rule of Law as an Institution

In the case of Argentina, the number of claims relating to breaches of BITs through expropriation or a breach of 'fair and equitable' treatment seeking a remedy from the ICSID has exploded. The net effect is that the ICSID is the forum of choice for investors to decide on approximately US$20 billion of claims, rather than the courts and regulatory apparatus of Argentina.[95] The identifiable risk here is that two competing systems are developing for the resolution of commercial disputes, one external forum for the foreign investor with a contract with the state for provision of services, and a domestic legal system for all other indigenous claimants. Empirical investigations into the effect of BIT arbitration on the development of strong legal institutions is thin, largely because regular use of international arbitration is fairly recent. As discussed earlier research by Ginsburg has shown that the presence of a BIT regime is negatively correlated with the development of regulatory and legal institutions in the host state.[96] It is important to note that this research examined the relationship between quantities of global BITs signed and judicial institutional quality, and not the effect of arbitrated disputes on particular countries. At this stage it is difficult to make an empirical statistical analysis of the quality of the domestic legal institutions dependent upon the increase in the number of claims taken to international arbitration. However there are trends that can be noted as to the way the disputes have played out which indicate a fracturing of the domestic rule of law.

Argentina has historically been plagued at times by repeated political crisis and authoritarian regimes, undermining the effective and impartial application of the rule of law in its civil courts. Indeed, foreign investor's choice to lodge claims directly to the ICSID claiming treaty breaches can partly be traced to a general mistrust in Argentina's judicial competence. Within Argentina itself the public has only 29% confidence in

[95] The Economist 2005
[96] Ginsburg 2005:119

Argentina's jurisprudence.[97] For foreign investors, a possible driving force pinning the claims to international arbitration remedies has been an increasing alignment of the Supreme Court with the executive over issues related to the ceasing of convertability. The former President Kirchner had been personally involved in selecting the justices and reforming the numbers that sit on the bench.[98] The court has consequently been more likely to support the government's policies on the pesofication of dollar-denominated debt, the renegotiation of existing privatization contracts with investors and measures which protect debtors in the wake of the crisis.[99] Such measures erode confidence in the rule of law regarding property rights on behalf of all investors both foreign and domestic. The courts unwillingness to go against the executive may represent a merging between the political and judicial spheres of a society in times of deep economic crisis. However, the fact that foreign investors have moved to seek special protection under BITs further politicises the treatment of foreign owned capital. This dynamic may potentially weaken the application of the rule of law as judicial decisions become exogenous to the legal system.

As the majority of the Argentine disputes lodged with the ICSID are related to investments that provide for energy and water related services, they are traditionally heavily regulated areas. The contracts which govern the concessions related to energy and water services are set up to include an independent regulator to ensure the provision of services based on consumer needs.[100] The power to set and review tariffs sits firstly with the regulator. However in the unfolding disputes regarding CMS, Enron, Sempra and LG&E, the regulatory powers of ENARGAS were supplanted by actions of the executive arm of the national government through the Emergency Law. By all accounts the handling of the tariff freezing prior to the end of convertability was not conducted well by ENARGAS and efforts to come to conciliation broke down.[101] There was therefore a lack of regulatory oversight and an eventual intervention by the executive. However, the resolution by foreign investors to take the claims to the ICSID

[97] Bertelsmann Stiftung 2007:8
[98] Bertlelsmann Stiftung 2007: 7
[99] Bertlelsmann Stiftung 2007: 7
[100] Enron at 14
[101] Enron at 63-69

has led in effect to the ICSID taking on a supervisory role for the regulatory authorities. The existence of BITs has been used as a means of evoking international jurisdiction over domestic energy distribution. The claimants in CMS, for example, argued that the Argentine domestic legislation to conduct and settle the disputes was more or less irrelevant. In this case the claimants stated that only the BIT and international law are applicable to the dispute while the law of the host State "plays only a marginal role, relevant only as a matter of fact".[102] Given that the ICSID tribunals consist of trade lawyers with experience in settling state to state trade disputes, there is a risk that the deciding of claims against Argentina over matters of service provision for basic utilities ignores the domestic regulatory environment. The wholly negative perception of the foreign owned service providers in making claims and succeeding in international arbitrations may undermine the development of independent regulatory authorities. Most of the industries which were privatized in the 1990s and purchased through concession contracts by foreign investors have only had independent regulators since that time. Particularly for matters in the claims that go beyond the justifications for pesofication and relate to regulator behavior, the use of international tribunals as an alternative to fighting claims through the domestic legal institutions pits the regulator and executive together on the same side and marginalizes the role of the domestic judiciary. It follows that application of a universal rule of law is severely compromised as the foreign investor sources legitimacy for its rights from external rather than local institutions.

This dynamic stems from the way in which BITs and the ICSID allows for foreign investor arbitration. This is also related to the question of whether or not the BIT system of treaty arbitration substitutes rather than complements the development of rule of law institutions in the developing country. The Argentine concluded BITs do not encourage local court participation in the resolution of foreign investor disputes. Under the US-Argentina BIT for example, foreign investors are able to apply directly to the ICSID for dispute resolution without first having exhausted local remedies.[103] This functions in

[102] CMS at 109
[103] Article VII paragraph 3(a) of the US-Argentina BIT states that "provided that the national or company concerned has not submitted the dispute for resolution under paragraph 2 (a) or (b)

combination with other rules of the ICSID which further isolate arbitration from the domestic courts. The ICSID Convention is an entirely exclusive forum, which means that there is no option for situations in which a party might go to the local courts for aid. Article 26 of the ICSID Convention locks out of the dispute settlement process, once begun, any part played by domestic courts to give a remedy.[104]

In terms of the general effect that FDI has on internal institutions, there are arguments that FDI can assist in facilitating the development of impartial, effective and efficient rule of law. This can theoretically be achieved by bringing mature and sophisticated foreign firms to the host country which can in turn assist in developing a rule of law beginning with their own business initiatives by "transferring to employees not only valuable business know-how and technical expertise, but expose them to a certain work ethic, business practices, ethical standards, and codes of conduct".[105] FDI may also encourage competition which serves to break the power which domestic monopolies and oligopolies wield over the judiciary and regulatory authorities.[106] Theoretically BITs create the necessary checks foreign investors need at the formative stages of entry into the host-state where the legal institutions are seen to be wanting. The provisions for international arbitration in this respect may be viewed as a temporary arrangement during a phase of institutional underdevelopment. When a country signs a BIT they are, as Reisman and Sloan put it, expected to establish "an effective normative framework: impartial courts, an efficient and legally restrained bureaucracy, and the measure of transparency in decision that has increasingly been recognized as a control mechanism over governments and as a vital component of the international standard of governance" (Reisman and Stone: 117).

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and that six months have elapsed from the date on which the dispute arose, the national or company concerned may choose to consent in writing to the submission of the dispute for settlement by binding arbitration", under which the ISCID is the first nominated arbitral forum. It is also stated specifically in the Letter of Submittal from the US Department of State to the US Senate for treaty ratification that the investments "have access to binding international arbitration in investment disputes with the host government, without first resorting to domestic courts", http://tcc.export.gov/Trade_Agreements/All_Trade_Agreements/exp_000897.asp

[104] "Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy"

[105] Hewko 2002: 20

[106] Ginsburg 2005: 119

These normative frameworks are, however, established to protect and benefit foreign investors. The BIT system serves to carve out special property rights and dispute resolution procedures from the host country, which effectively means that foreign investments are insulated from the legal and political risks of relying on the host state institutions. Non-reliance on potentially corrupt and biased institutions is a key reason for the adoption of the BIT system- it offers external dispute resolution unhindered by the machinations of the home state. The use, however, of the ICSID dispute mechanisms, or perhaps more accurately described as the avoidance of the host-country legal process, could have particularly counterproductive effects on the development of good regulatory and legal institutions. The case of Argentina suggests that BITs are a quick fix to a wide range of failed and poorly functioning internal legal institutions which have partly led to chronic macro instability. In the vast privatization program undergone by Argentina since the late 1980s, the utilities and resource-based former state owned companies were purchased by a large number of foreign stakeholders. This influx of FDI has been largely permitted to circumvent the local legal system through the BIT program. One direct result is that the foreign investors have detected a way to participate in a local economy which is plagued by repeated economic crisis without investing resources or lobbying for the creation of a regulatory and legal environment which is more transparent, rule-bound and impartial. There are at least 35 different foreign investors using treaty arbitration over and above the internal legal avenues. The majority of these investments are large-scale infrastructure projects and utility management companies. With such a large case load representing vital economic sectors cordoned off into external arbitration, there is a removal of the voice of foreign investors from the internal debate over the need for well developed laws and institutions. Foreign investors are first and foremost concerned with making profit, not with the institutional development of the host state. However the granting of special rights, in particular the option to resolve disputes through international arbitration, reduces foreign investor reliance on improving legal institutions.

The claims lodged with the ICSID are for the most part concerned with these privatized utility industries. The rationale behind their privatization deserves greater attention

beyond the scope of this paper, but it is a fair assumption to make that the reforms through privatization were aimed at upgrading the service provision of gas, electricity and water with the added value of foreign technology and management knowhow. There was a concerted effort therefore to involve foreign investors in the bidding process, which also increased the asset sale price.[107] However the heavy influx of foreign capital into the country was conditioned upon there being some form of protection available to investors from acts of expropriation. Such investments sought protection because they involved substantial sunk costs over a long time frame. The design of the legal relationship between the foreign investor and the Argentine state therefore became a crucial issue. On the one hand, the foreign investors faced unknown threats as to the extent of which they are vulnerable to opportunism by the state once the investment is made. On the other hand, from the host state's view, the investments were for projects which were public goods and also which wielded significant monopolizing power. Within such a bargaining process there exists significant information asymmetries, and it appears that the conclusion of BITs with the capital exporting states was one solution. The association of signing BITs at the same time of large-scale acquisitions of state-owned utilities is not a coincidence – it was part of the overall package of reforms negotiated together with the Menem Administration and the IMF.[108]

The question then becomes what would have happened in the scenario where the BIT agreements had not been concluded. If there had not been some treaty to substitute the perceived underdevelopment of the domestic legal and regulatory institutions, the foreign acquisitions may not have been as copious as they were. The denial of FDI in such circumstances would have sent a signal that in spite of the potential market, foreign investors would first demand an adequate and functioning regulatory environment which protected their interests. From the foreign investor claims analyzed in this paper, it appears that the existence of licenses with favorable terms on the collection of tariffs in US dollar denominated currency combined with the promise of property rights that were treaty protected overcame an insufficient regulatory regime.

[107] Bouzas 2004:7
[108] Mortimore 2008:21

Likewise the regulatory regime represented by ENARGAS failed to incorporate the social and economic interests of the users of the service by not accounting for the potential problem of risk allocation in the event of a currency crisis. The proceedings in the case of Sempra highlight the problem of incomplete regulation. The regulatory framework "did not foresee what should be done in case the Convertibility Law was abandoned"[109]. Argentina argued in its defence that it would fall to the Government to adapt the licenses in the event of such a change, while the claimants put forward their view that they had acquired a property right to calculate tariffs in US dollars as this is what the license specified. The regulator ENARGAS had not made any preparations on where risk fell in the event that the convertability plan ended. The omission to do so at the regulator level demonstrates a lack of coherent planning. Yet the fact is that the licensees were offered generous returns based on the promise of tariff calculation in US dollars under the terms of the license and as proffered during the bidding process.[110] This was an enticement on behalf of the government during privatization bidding process in order to increase the attractiveness of the investment and (which would have increased the sale price). Knowledge of how stringently the arbitrators would interpret the BIT was not obvious, and this is one of the identifiable problems of the BIT regime, however the absence of clearly delimited legal rights between the licensees and the community for which ENARGAS was meant to serve demonstrates the deficiencies inherit in the regulatory environment before the investments were made. The BIT gave both cover for the foreign investors to enter a country with infant and undeveloped regulatory oversight and it offered the host-state higher financial rewards and foreign management skill over utility distribution without ensuring their were defined functions and powers for the regulator in the event of a currency crisis.

With a developmental level close to Argentina's, a comparison with the Chilean privatization program which began in the 1980s serves to highlight the development of domestic legal and regulatory institutions in the absence of BIT regime influence. First of all Chile did not sell off its state owned utility industries to foreign investors. The program was largely the result of a national consensus long-term strategy which sought to

[109] Sempra at 137
[110] CMS at 128, LG&E at 42, Enron at 96, Sempra at 85,

balance macroeconomic goals, the development of capital markets and sound regulation.[111] The process of utility privatization was not without the institutional problems and licensee-regulator conflict. Basanes et al however notes that the experiences of institutional difficulties in Chile's privatization of the electricity market were considered for the implementation of Chile's highway franchising program, with largely successful outcomes as far as creating an independent and effective regulator.[112] In this way the privatization was an endogenous learning experience marked by national economic actors operating within the boundaries of Chilean law. In contrast the process of regulatory development in Argentina has been confounded by the consequences of treaty bound contractual relationships with foreign investors. The use of BITs as a short-cut method to attract FDI has appeared to handicap the incentive to initiate long-lasting legal and regulatory reform.

8 CONCLUSION

The emerging foreign investor regime of BITs provides private actors with an option to arbitrate against nation-states through the ICSID. The BITs by themselves are unclear as to the actual meaning of the terms contained within, and it is only through interpretation at the time of arbitration that the policy intention crystallizes. In this paper I have first asked how the ICSID has interpreted the BITs, and what to what extent this places limitations on the exercise of economic sovereignty by the host state. Through the case study of Argentina I have found that the principle of fair and equitable treatment is interpreted so as to grant foreign investors superior property rights within the host state relative to domestic actors. The outcome has been to provide legally-sanctioned insulation from country macroeconomic risk ex post. The host state policy space to effectively mobilize all economic resources in a time of crisis is therefore restricted under the BIT. Whether or not there will be an increase in foreign investor claims for similar risks in other countries remains to be seen. However the granting of superior property rights to foreign investors in such circumstances suggests countries that countries which have sought to integrate themselves into the global economy

[111] Solanes & Andrei 2007: 18
[112] Basanes 1999: 33

through the adoption of BITs face declining property protections for local actors vis-a-vi foreign investors.

Secondly I have asked how this treaty system impacts on the development of the rule of law within the host state. The case study shows that foreign investors have consistently sought treaty arbitration to resolve their disputes rather than pursue claims through the local legal channels. It is unsurprising given that the majority of their claims seek compensation for currency risk, which the domestic courts are unlikely to provide. The identifiable problem is that the prospect of BIT arbitrated claims has made foreign investors unaccountable to reforming deficient institutions within the host country. What this study has potentially further identified is that the problem rests by and large at the regulatory level. The regulatory system did not consider the problem of an end of convertability. The licenses with the foreign investors on the other hand offered US dollar denominated tariff setting. The BIT gave foreign investors a way to overcome the potential risks while the host state could sell its state enterprises for a high margin without implementing a regulatory regime that considered the inherent problems of currency instability. In this way the BIT regime appears have acted as an escape valve to relieve deeper regulatory reform efforts in order to attract foreign investment. In comparison Chile pursued its privatization program in the absence of large foreign stakeholders with treaty protected property rights, with more or less successful results. In Argentina the incentive to reform its regulatory institutions to prepare the ground for private utility management was arguably weakened, or at the least scuttled, by the quick-fix that BITs offered to attract foreign capital. It is difficult to determine whether the increase in arbitrated claims have consequently had a negative impact on the internal judicial institutions as they are very recent. The main finding is that at the point of entry, the existence of the BIT is associated with incomplete regulatory apparatus. Further studies of the regulatory design of host states and its association with BIT-covered foreign investments would be an important next step.

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