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THE ICSID CASE LAW RELATED TO NON-PRECLUDED MEASURES CLAUSES: IMPACT ON INVESTORS AND ALTERNATIVES[1]

La jurisprudencia del CIADI sobre cláusulas de emergencia en acuerdos de protección a la inversión: Impacto sobre inversionistas extranjeros y alternativas posibles

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ABSTRAC:
The ICSID case law on non-precluded measures clauses transfers significant risks during economic crises to investors. This article puts the case law in a broader context and shows that not all investors could be affected by it in such events. Moreover, the article highlights that the suspension of compensation proposal as a risk sharing mechanism between investors and host States during economic collapses is more theoretical than practical. Thus, other formulas should be explored. The present article puts forward one: shortening the length of the crisis. This is an important tool to allocate risks. By virtue of the operation of the clause, setting the period between the start and end dates of the crisis at the shortest length possible, while accepting the severity of the crisis, allows tribunals to alleviate the burden of the risks borne by foreign investors, since once the crisis is considered finished, full compensation is owed to them and the risks are shifted to host States, even if their economies may not have returned to normality. The article expands the analysis of this proposal on the basis of the literature in economics on how to determine the end of economic breakdowns. The article presents two leading perspectives and shows their impact on States and investors if applied in the context of litigation in which the invocation of an NPM clause has been successful.

KEY WORDS:
foreign investment, economic crises, non – precluded measures clauses, allocation of risks between host States and foreign investors.

RESUMEN:
La jurisprudencia de los tribunales internacionales de arbitramento del Centro Internacional de Arreglo de Diferencias relativas a Inversiones (CIADI) sobre cláusulas de emergencia transfiere de manera significativa los riesgos durante crisis económicas a los inversionistas. Los Estados receptores de inversión no tendrán que compensar a los inversionistas por los efectos adversos que los últimos hayan sufrido como consecuencia de las medidas adoptadas por aquellos para enfrentar tales eventos. El presente artículo ofrece un contexto más amplio de dicha jurisprudencia e ilustra que no todos los inversionistas se verían afectados por ella en tales circunstancias. A pesar de ello, el articulo sugiere que deben diseñarse mecanismos que impliquen que los riesgos de los Estados y los inversionistas extranjeros sean compartidos en cierta medida durante severos colapsos económicos. Uno de ellos es la reducción de la duración de la respectiva crisis por parte de los tribunales. En tal virtud, y en el evento del éxito de la defensa invocada por el Estado receptor y basada en la cláusula de emergencia, no compensación será ordenada para el inversionista como resultado de las medidas emitidas durante el periodo de emergencia, pero sí lo será en relación con aquellas medidas que se decretaron con posterioridad a la fecha de terminación “anticipada” de la crisis decretada por el tribunal.

PALABRAS CLAVES:
inversión extranjera, crisis económicas, cláusulas de emergencia, distribución de riesgos entre Estados receptores e inversionistas extranjeros.

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The case law on non-precluded measures clauses in international investment agreements rendered by international arbitration tribunals under the jurisdiction of the International Centre for the Settlement of Investment Disputes (ICSID) remains controversial. Attempts to adjust some of the more significant consequences of this jurisprudence continue to be developed by scholars. Alan Sykes is among those who have embarked upon this undertaking by offering a multi-layered analysis of the defense of "necessity" in international investment disputes.

Sykes' main proposition is that the obligation to compensate investors for government measures adversely affecting their investments during economic emergencies mitigates the risk of moral hazard and incentivizes States to "select the least expensive way to protect their interests (the optimal policy instrument)."[1] Otherwise, he points out, "actors will take risks that imperil them to an excessive degree if they can save themselves by imposing costs on others."[2] Sykes, nonetheless, recommends that payment of the compensation could be deferred in light of the emergency and that it not be subject to market interest rates. [3]

He derives his proposal from law-and-economic analysis and in light of the case law generated by litigation against Argentina resulting from its 2001 economic collapse and its invocation of the non-precluded measures clause included in Article XI of the U.S. – Argentina Bilateral Investment Treaty:

This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the Protection of its own essential security interests.[4]

In recent years, some of this case-law rendered under the ICSID jurisdiction has indicated that the successful invocation of non-precluded measures clauses (NPM clauses) prevents violations of the treaty.[5] Consequently, according to such case law, the State owes no compensation to investors for damages caused by measures aimed at coping with the crisis during situations of emergency,[6] and such measures may be permanent and need not be removed as soon as the emergency subsides.[7]

1 *See* Alan O. Sykes, *Economic "Necessity" in International Law*, 109 American Journal of International Law 296, 321 – 22 (2015).
2 *See id.* at 299.
3 *See id.* at 320.
4 Treaty Between the United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment, U.S.-Argentina. Signed November 14, 1991.
5 *See Sempra Energy International v Argentine Republic*, Decision on Annulment, ICSID Case No. ARB/02/16, June 29, 2010, at para. 200. [*Sempra Annulment Decision*].

This case law transfers many of the risks during situations of emergency to investors, while the quite strict approach of the customary rule of necessity embodied in Article 25 of the International Law Commission's Articles on Responsibility of States for Internationally Wrongful Acts does just the opposite. It provides as follows:

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 obligation of that State unless the act:

   (a) is the only means 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 State 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 precludes the possibility of invoking necessity; or
   (b) the State has contributed to the situation of necessity.[8]

As to the effects, Article 27 of the ILC Articles establishes that compensation can be negotiated by the State invoking necessity[9] and that compliance with the international obligation must take place once the situation of necessity ends. [10]

6 *See CMS Gas Transmission Company v Argentine Republic,* Decision of Annulment, ICSID Case No. ARB/01/8, September 25, 2007, at para. 146. [*CMS Annulment Decision*], and *Sempra Annulment Decision*, *supra* note 5, at para. 118.

7 The international law of necessity is a very dynamic area of public international law and international investment law due to the significant number of international decisions and to the booming scholarship they have engendered. *See*, among many, William W. Burke-White & Andreas von Staden, *Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Treaties*, 48 Virginia Journal of International Law 307 (2007-2008), Jacques Werner, *Revisiting the Necessity Concept*, 10 Journal of World Investment and Trade 549 (2009), Jurgen Kurtz, *Adjudging the Exceptional at International Investment Law: Security, Public Order and Financial Crisis*, 59 International and Comparative Law Quarterly 325 (2010), Andrea K. Bjorklund, *Economic Security Defenses in International Investment Law*, 1 Yearbook on International Investment Law & Policy 479 (2009), Michael Waibel, *Two Worlds of Necessity in ICSID Arbitration: CMS and LG&E*, 20 Leiden Journal of International Law 637 (2007), José E. Alvarez & Kathryn Khamsi, *The Argentine Crisis and Foreign Investors. A Glimpse into the Heart of the Investment Regime*, 1 Yearbook on International Investment Law and Policy 379 (2008/2009), José E. Alvarez and Tegan Brink, *Revisiting the Necessity Defense:* Continental Casualty v. Argentina, Yearbook on International Investment Law and Policy 319 (2010/201100), Théodore Christakis, *Quel Remede A L'Eclatement de la Jurisprudence CIRDI sur les Investissements en Argentine? La Decision du Committe* Ad Hoc *Dans L'Affaire CMC c. Argentina*, CXI Revue General du Droit International Public 879 (2007), Campbell McLachlan, *Investment Treaties and General International Law*, 57 International and Comparative Law Quarterly 361 (2008), Stephan W. Schill, *International Investment Law and the Host State's Power to Handle Economic Crises.* Comment on the ICSID Decision in LG&E v. Argentina, 24 Journal of International Arbitration 265 (2007), August Reinisch, *Necessity in International Investment Arbitration—An Unnecessary Split of Opinions in Recent ICSID Cases? Comments on* CMS *v.* Argentina *and* LG&E *v.* Argentina, 8 Journal of World Investment & Trade 191 (2007), Emmanuel Gaillard, *Chronique des Sentences Arbitrales. Centre International pour le Règlement des Différends Relatifs aux Investissements*, 134 Journal du Droit International 335 (2007) ; Antoine Martin, *Investment Disputes after Argentina's Economic Crisis: Interpreting BIT Non-precluded Measures and the Doctrine of Necessity under Customary International Law*, 29 Journal of International Arbitration, 49 (2012); Andrew Mitchell and Caroline Henckels, *Variations on a Theme: Comparing the Concept of 'Necessity' In International Investment Law and WTO Law*, 14 Chicago Journal of International Law 93 (2013); Diane A. Desierto, *Necessity and Supplementary Means of Interpretation for Non-Precluded Measures in Bilateral Investment Treaties*, 31 Journal of International Law 827 (2014); Elizabeth A. Martinez, *Understanding the Debate Over Necessity: Unanswered Questions and Future Implications of Annulments in the Argentine Gas Cases*, 23 Duke Journal of Comparative & International Law 149 (2013); Anne van Aaken, *Smart Flexibility Clauses in International Investment Treaties and Sustainable Development. A Functional View*, 15 Journal of World Investment & Trade 827 (2015).

8 International Law Commission, *Articles on Responsibility of States for Internationally Wrongful Acts, with commentaries 2001*, at 80. [ILC's Commentaries]. http://legal.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf.

9 The ILC expresses:
It will be for the State invoking a circumstance precluding wrongfulness to agree with any affected States on the possibility and extent of compensation payable in a given case.
Id. at 86.

In its judgment in the *Case Concerning the Gabcikovo - Nagymaros Project (Hungary/Slovakia)*,[11] the International Court of Justice ruled that the foregoing precept had the status of customary international law;[12] that the concept had to be interpreted very narrowly,[13] since it served to excuse wrongful acts under international law; and that the requirements must be satisfied cumulatively by the State invoking necessity.[14] The bar is certainly high for States, a fact evidenced by Argentina's experience with this provision.[15] As can be seen, the interpretation of Article 25 advocated by the Court substantially transfers risks to States during economic collapses.

Basically, there is almost no risk-sharing mechanism between States and investors during economic collapses in the case law under these two provisions (article XI of the BIT and Article 25 of the ILC Draft), and something should be done about it. Sykes advocates for a substantial change in the interpretation of NPM clauses to provide for risk sharing. Conceptually, the present author agrees with this goal but offers another way to achieve it, rooted in the current case law on NPM clauses.[16]

This article has four parts. The first puts the case law in a more general context and posits that some investors, but not all, may escape or have its effects mitigated. The second part discusses Sykes' recommendation of deferral of compensation and shows its important limitations in practice: arbitration tribunals may have to order such deferral only in very exceptional circumstances. The third part explores the present author's proposal, that of narrowing the length of crises, that could be used by arbitration tribunals fully applying the ICSID case law in a way that achieves a more balanced allocation of risks between host States. The proposal relies on recent research in economics related to how to determine the extent and end of economic collapses. The fourth part offers the conclusions.

1. New Investors Could Mitigate the Effects of the ICSID Case Law on NPM Clauses

To begin with, it seems important to put the impact of the case law for foreign investors in perspective to offer a clearer picture of the impact of the former on the latter. The fact that significant risks have been transferred to them during economic collapses does not mean that investors will actually always bear all costs if such an event takes place.

10 *Id.* at 85.

11 International Court of Justice, *Case Concerning The Gabcikovo-Nagymaros Project (Hungary/Slovakia)*, Judgment of 25 September 1997 IC.J. Reports 1997, p 7.

12 *See id.* at para. 51.

13 *See id.*

14 *See id.* For a complete assessment of the requirements *see* Andrea K. Bjorklund, *Emergency Exceptions: State of Necessity and* Force Majeure, *in* Oxford Handbook of International Investment Law (Peter Muchlinski, Federico Ortino & Christoph Schreuer eds, 2008) 459, 474 – 88.

15 In the following cases, Argentina's invocation of Article 25 has failed: *See* Award, *CMS Gas Transmission Company v. the Argentine Republic*, ICSID Case No. ARB/01/8, 12 May 2005, at paras. 57 & 65 [*CMS Award*]; Award, In the Matter of an UNCITRAL Arbitration, *National Grid P.L.C.* v. *Argentine Republic*, 3 November 2008, at paras. 257 – 62; Decision on Liability, *Suez, Sociedad General de Aguas de Barcelona S.A, and Vivendi Universal S.A. v. the Argentine Republic*; *AWG Group v. the Argentine Republic*, ICSID Case No. ARB/03/19, 30 July 2010, at paras. 260 – 65 [*Suez, Vivendi & AWG*]; Decision on Liability, *Total S.A. v. the Argentine Republic*, ICSID Case No. ARB/04/1, 27 December 2010, paras. 220 – 24; and Award, *EDF International S.A., SAUR International S.A. and Leon Participaciones Argentinas S.A. v. Argentine Republic*, ICSID Case No. ARB/03/23, 11 June 2012, at paras. 1171 – 76.

16 *See Author*.

To begin with, one may expect investors to react to this case law when they carry out new investments in host States party to BITs with NPM clauses.[17] There might be many strategies to do so. The first is for investors to get political risk insurance (PRI) for new investments to cover the risk of the adoption of adverse measures as a result of economic crises.[18] Thus, in the event of an economic collapse that has prompted the host State to adopt measures adversely affecting the insured investor, the latter will file a claim with the PRI insurer under the insurance contract, instead of a claim against the host State before an investment arbitration tribunal. If the investor is paid,[19] it may well remain operating in the host country,[20] and the given insurance company will have a claim against the host State. If the insurer is a public entity, such as the U.S. Overseas Private Investment Corporation (OPIC), the whole issue will be transformed into an inter-State affair[21] and will no longer be an exclusive investment dispute.[22]

As can be seen, an economic collapse took place and the host State applied measures adversely affecting the insured investor, but the insured investor mitigated its costs, since it had previously transferred the risk to its insurer. In sum, the ICSID case law on NPM clauses may sometimes have little impact on properly insured investors.

The second strategy for investors reacting to the case law is to transfer *ex ante* some of the potential costs of economic crises to the host State. Such transfer would take place by investors requiring a higher return in advance during the investment to mitigate, or compensate for, losses arising out of any potential economic collapse. In other words, risky host States parties to BITs with

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17 *See* Robert Ginsburg, *Political Risk Insurance and Bilateral Investment Treaties: Making the Connection*, 14 Journal of World Investment & Trade 943 (2013); and Anne van Aaken, *On the Necessity of Necessity Measures: A Response to Alan O. Sykes*, 109 AJIL Unbound 181, 184 (2015).
Political risk insurers can be public, private or multilateral. Among the latter a prominent one is the World Bank's Multilateral Investment Guarantee Agency (MIGA). On its history and role in the settlement of investment disputes, *see* Ibrahim F. I. Shihata, *The Settlement of Disputes Regarding Foreign Investment: The Role of the World Bank, with Particular Reference to ICSID and MIGA*, 1 American University International Law Review 97, 106 (1986).

18 To be sure, this is not to say that political risk insurance should *only* be obtained to cover investors' risks during economic crises. PRI can be needed for coverage against other risks not linked to these particular events. Generally speaking, PRI may cover: expropriation, inconvertibility of funds, subsequent material changes to projects by States, political violence, and terrorism. *See* Clint Peinhardt & Todd Allee, *Political Risk Insurance as Dispute Resolution*, 7 Journal of International Dispute Settlement 205, 216 (2016).

19 The protection accorded to investors by BITs and PRI can vary. PRI can offer protections that BITs do not offer, and the protection can be partial or total. There might also be opportunities in which the protection offered by PRI is lower than that of a BIT. *See* in this regard, Ginsburg, *supra* note 17, at 961.

20 *See* Peinhardt & Allee, *supra* note 18, at 206.

21 *See id.* at 208 – 10. These authors argue that OPIC has a recovery rate of 90%, which suggests that the inter-State affair has ended through negotiations. *See id.* at 209. Further, in the event of PRI, there are negotiations between the investor, the host State and the public insurer dealing with the insured investor's claim. Peinhardt & Allee so describe them:
For government PRI insurers, however, settlement of claims is often accompanied by efforts to communicate with the host government and to discuss settlement options. Thus, agreement to pay the claim is often accompanied by the agreement of the host government to compensate the insurer for its payout. *See id.* at 214. For the role of MIGA, *see* Shihata, *supra* note 17, at 114.
To be sure, the mere existence of PRI does not always prevent investment arbitration. If the given risk is not covered by the PRI policy and the insurer rejects the investor's claim, then the latter can still start arbitration against the host State. *See id.*

22 Article 9.13 of the Trans-Pacific Partnership Agreement recognizes explicitly deals with this situation:
Article 9.13: Subrogation
If a Party, or any agency, institution, statutory body or corporation designated by the Party, makes a payment to an investor of the Party under a guarantee, a contract of insurance or other form of indemnity that it has entered into with respect to a covered investment, the other Party in whose territory the covered investment was made shall recognise the subrogation or transfer of any rights the investor would have possessed under this Chapter with respect to the covered investment but for the subrogation, and the investor shall be precluded from pursuing these rights to the extent of the subrogation.

NPM clauses may already be paying a premium in new investments as a result of this case law. In sum, if an economic crisis takes place, and despite the ICSID case law, foreign investors may have mitigated well in advance the costs of measures adversely affecting their investments.[23]

Concluding, foreign investors can react to the ICSID case law by totally or partially transferring the risk of economic collapses to insurers through PRI or to host States through higher premiums during the life of the investment before such events. This certainly does not mean that efforts to get a more balanced approach in the ICSID case law are not necessary.

Indeed, this case law might have, for instance, a large, adverse impact on old investments that pre-dated it, for which investors either did not get PRI or could not demand a premium in part or in full and, therefore, could not fully adjust to the jurisprudence. Future economic crises in their host States may lead to unbearable risks for this type of investor, so there would be a need for seeking ways to share risks with host States during these critical times. These are the investors who most likely will bring cases under the investor/State dispute settlement systems in BITs.[24]

This is then one of the reasons to try to create risk-sharing mechanisms within the context of the current case law on NPM clauses. Undoubtedly, the purpose is not to defeat the parties' intentions in BITs, but to make sure that both host States and foreign investors receive protection at the end during economic collapses. One way to achieve this objective is through Sykes' proposal. It has two elements: the existence of compensation during crises even if the NPM is successful, and the deferral of the said compensation.[25] The underlying reason for the latter is that compensation could be paid if it could be afforded.[26] Given that the compensation can be suspended, it can be afforded by host States. In the present author's view, this suspension is more theoretical than practical, as will be shown below.

2. Suspension of Compensation: From Theory to Reality

The instrument of compensation would indeed help align host States' and investors' interests

23 Diversification may also be an additional strategy to deal with the case law. When an investor has diversified its investments within a host country, the fact that one of them has been affected by measures adopted as a result of an economic crisis may not necessarily lead to investment litigation. Under these circumstances, an investor may try to compensate its losses totally or partially with present or expected profits from other current or future investments, thereby avoiding litigation.
There are is another indirect way for foreign investors to mitigate risk during economic collapses: granting the host State a minority stake in the investment. The expectation is that the host State will try not to interfere with the given project in order to preserve the value of its own investment. *See* Barclay E. James & Paul M. Vaaler, *Minority rules: State Ownership and Foreign Direct Investment Risk Mitigation Strategy*, Columbia FDI Perspectives. No 111. December 23, 2013. http://ccsi.columbia.edu/files/2013/10/No_111_-_James_and_Vaaler_-_FINAL_-_with_Figure.pdf.

24 Assuming that the investor is no longer interested in a long-term relationship with the host State and arbitration is the instrument of last resort to seek redress. *See* Cedric Dupont, Thomas Schultz & Merih Angin, *Political Risk and Investment Arbitration: An Empirical Study* 7 Journal of International Dispute Settlement 136, 137 (2016), and Peinhardt & Allee, *supra* note 18, at 215.

25 To recall, suspension of compensation may consist, as Sykes suggests, in delaying payment of the damages awarded from the date of breach until a specific date. Interest rates lower than market rates would also be included until such date. *See* Sykes, *supra* note 1, at 320. For additional grounds for suspension, *see* van Aaken, *supra* note 17, at 185.

26 *See* Sykes, *supra* note 1, at 321.

during economic crises. However, it is important to make clear that suspension of compensation would not always be required. To illustrate this point, three situations must be distinguished and the length of litigation in light of recent experience must be considered.

(i) The award is rendered and the given crisis is still ongoing;
(ii) The award is issued shortly after the economic collapse ended; or
(iii) The award is rendered long after the crisis ended.

First, the case for suspension is very strong when, at the time of the award, the crisis is still ongoing and the government may be concentrating its resources on more pressing needs.[27] The second situation is when the award is rendered shortly after the economic calamity has ended and suspension is required so as to not jeopardize the recovery. This would include borderline cases, but tribunals' discretion to suspend compensation would be important for the benefit of host States. Finally, in a third situation, the case for suspension would be very weak when the award is issued several years after the crisis had ended. In this event, there would be no reason for the deferral, since, as a result of its economic recovery, the host State could well pay the compensation.

Litigation prompted by Argentina's economic crisis offers an opportunity to further expand on the analysis of Sykes' proposal. Table 1 presents the length of the litigation just for the arbitration proceedings in some awards from the Argentine saga in which an NPM clause or the customary rule of necessity has been invoked and Argentina has been ordered to compensate the claimant investor.

The approximate average of these proceedings is 6 years 2 months. So, if it is a proxy for the length of time of litigation prompted by economic collapses, the suspension of compensation would be an important tool when the crises last more than seven years. The Great Recession illustrates that protracted economic crises do exist, so there is value in Sykes' proposition.

Thus, the data on Argentina's litigation narrows the practicability of Sykes' suspension proposal to those events in which the award ordering compensation is rendered shortly after the given crisis has ended, since protracted crises lasting more than 6 years are more the exception than the rule. In reality, economic collapses that lasted four or five years would be the ones in which the deferral could be available.[28] For shorter calamities, awards would have been rendered four or five years after their culmination, and in principle, there would no reason for the deferral.

Further, applying Sykes' proposal to Argentina itself confirms the practical limitations of the deferral of compensation. In effect, the *CMS* award is the one that has set the longest length for the crisis. According to it, the crisis ended sometime between the end of 2004 and the beginning of 2005.[29] Even if one takes this length as the standard—which, in fact, has not been followed by another, as will be seen below[30]—

27 The argument would not include compensations ordered in connection with measures or actions unrelated to the resolution of economic crises.

28 Assuming that litigation started shortly after the crisis started, in which case the award was rendered one or two years after the collapse ended. However, if litigation started at the end of the crisis, let's say in its third or fourth year, the award would be rendered five or six years after the said collapse ended, and therefore, there would be no need for a suspension of compensation. In sum, the applicability of Sykes' proposal would not necessarily apply to certain crises, even if they lasted four or five years.

29 See CMS Award, supra note 15, at para. 250.

30 *See infra* note 32 and accompanying text.

the suspension of compensation would have hypothetically been available in relation to only those awards rendered two to three years later, or until 2007, namely, just three awards, *CMS*, *Enron*,[31] and *Sempra*.[32] For all of the other awards from the Argentinian saga, tribunals would not really need to think about any deferral.[33]

But in addition, the proposal seems to be further limited by the fact that, as the Argentine saga evidences, there is a *de facto* suspension already in place. This *de facto* suspension takes place when the parties bring annulment proceedings and request a stay of enforcement of awards on the basis of Article 52 of the ICSID Convention in cases brought under the ICSID. Table 2 below illustrates that, on average, annulment proceedings have lasted two years and four months. If one adds the 120 days parties have to file the annulment application,[34] this *de facto* extension of suspension is roughly three years.

Thus, in practical terms, a tribunal weighing a decision to suspend compensation in the exceptional event of a protracted crisis, would need to take into account that an annulment proceeding and stay of enforcement of the award is likely to take place and that the compensation will not likely be paid within the subsequent three years.

The average of the length of annulment proceedings shows that, at the end of them, the given crisis has already ended or ended a good number of years ago, so tribunals may not need to order such suspension in their awards.[35]

This is certainly not to say that Sykes' suspension proposal does not deserve attention. It does, and it could be useful in exceptional circumstances. In any case, the present author's analysis leaves intact Sykes' proposal that compensation is due to investors when NPM clauses are successfully invoked.[36] In other words, if compensation is due, there is no need to propose its suspension in order to make it more palatable. Host States could generally afford the compensation.

3. An Alternative to Mitigate the No-Compensation Effect of NPM clauses[37]

The challenge that Sykes and other likeminded scholars face is that the case law on NPM clauses seems to have been settled in the ICSID case law, since there is already a number of cases going in the same direction regarding how the clauses

31 *See Enron Corporation Ponderosa Assets, L.P v. Argentine Republic*, ICSID Caw No. ARB/01/3, May 22, 2007.

32 The *LG&E* decision on liability could be excluded since the tribunal stated that the crisis had ended in April 2003. *See LG&E Energy Corp. v. Argentine Republic,* Decision on Liability, ICSID Case No. ARB/02/1, October 3, 2006, at paras. 226 – 29. [*LG&E Decision on Liability*]. Thus, by the time of the award, Argentina had been in the fourth year of its recovery, and the suspension of compensation would have been unnecessary.

33 The average length of litigation is long enough to raise another issue: that awards may be rendered at a time of a different subsequent crisis. Certainly, suspension of compensation should not be available under this circumstance, not even exceptionally. Opening the door to this kind of claim would create a moral hazard problem.

34 *See* Article 52(2) of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention). 17 UST 1270, TIAS 6090, 575 UNTS 159.

35 To deal with the point that tribunals should not be making decisions of suspension on the uncertain basis of the potential existence of annulment proceedings, a tribunal could decide that compensation could be deferred up to a certain number of years, if the host State does not institute annulment proceedings. Such suspension would not take place in the event of such proceedings.

36 Sykes shows the benefits of the compensation as an element of NPM clauses on the basis of law & economics, but he leaves it to others—tribunals and commentators—to show how the proposal fits into the interpretation of particular NPM clauses under specific BITs.

37 Space constraints prevent the present author from exploring other elements of NPM clauses aimed at protecting host States' interests in the interpretation of NPM clauses. Paramount among them is the requirement of lack of contribution to the given economic collapse provided for in Article 25 and equally applicable to NPM clauses. An interpretation of this requirement in a way that preserves States' regulatory powers is left for future research.

operate.[38] Furthermore, attempts to introduce compensation within NPM clauses in ICSID disputes, absent explicit treaty words, could be seen as a failure to apply the applicable law, the NPM clause, and make a tribunal's conclusion void on the basis of Article 52.1(b) of the ICSID Convention—on the manifest excess of powers.[39]

In addition, the case law clearly favors States, which are the ones that negotiate bilateral investment treaties.[40] With the Great Recession still hurting, States may just be satisfied with the large scope of regulatory power this case law accords to them. Moreover the NAFTA experience shows that, when States are unsatisfied with the evolution of the case law rendered by investor/State tribunals under an investment treaty, they agree on an interpretation that seeks to correct or adjust the given undesired jurisprudence.[41] No interpretation of this nature has been issued, to the present author's knowledge. In sum, there is unlikely to be a change in the current state of the law regarding NPM clauses.

However, given the proliferation of BITs, the varied texts of NPM clauses, and the fact that not all investor/State disputes will be adjudicated by tribunals under the ICSID Convention and the ICSID jurisdiction, it cannot be ruled out that Sykes' proposal of compensation could be embraced in the future by other non-ICSID tribunals.[42]

Nonetheless, for those unsatisfied with the ICSID case law an alternative is to recommend mechanisms that achieve a more balanced allocation of risks between investors and States during economic collapses but within the framework of the this case law. One way is through the determination of the length of the economic crisis.

Arbitration tribunals have the last word regarding the length of the existence of the need for the application of the BIT NPM clause and can use it to control the impact of the successful invocation of the clause. The shortening of the length of the crisis is an important tool to allocate risks between investors and host States when the NPM clause is successfully invoked. By virtue of the operation of the clause, setting the period between the start and end dates of the crisis at the shortest length possible *while*

38 *See CMS Annulment Decision*, *supra* note 6, at paras. 129 – 35; *Sempra Annulment Decision*, *supra* note 5, at paras. 112 – 15; *LG&E Decision on Liability*, *supra* note 32, at paras. 229 – 42; Award, *Continental Casualty Company v Argentine Republic*, ICSID Case No ARB/03/9, September 5, 2008, at paras. 162 – 68 [*Continental Award*]; and *El Paso Energy International Company v. the Argentine Republic*, Award of 31 October 2011. ICSID Case No ARB/03/15, at paras. 621 – 26 & 650.
The ICSID case law is, in this sense, consistent even if it has dealt with a single NPM clause, Article XI of the Argentina – U.S BIT.

39 For this line of reasoning, *see*, for instance, *Sempra Annulment Decision*, *supra* note 5, at paras. 208 – 9.

40 *See* Caroline Foster, *A New Stratosphere? Investment Treaty Arbitration as 'Internationalized Public Law'*, 64 International and Comparative Law Quarterly 461 (2015).

41 *See* NAFTA Free Trade Commission, *Notes of Interpretation of Certain Chapter 11 Provisions* (July 31, 2001), http://www.sice.oas.org/tpd/nafta/Commission/CH11understanding_e.asp.

42 By virtue of different BITs, Investment arbitration can also take place under the UNCITRAL Arbitration rules, the ICSID Additional Facilities Rules, the Rules of the International Chamber of Commerce, the Rules of the London Court of International Arbitration, and the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce. For a detailed analysis of their advantages and disadvantages, *see* Piero Bernarddini, *ICSID Versus Non-ICSID Investment Treaty Arbitration*. (2009). http://www.arbitration-icca.org/media/4/30213278230103/media012970223709030bernardini_icsid-vs-non-icsid-investent.pdf.

recognizing the existence of severe economic strain allows tribunals to alleviate the burden of the risks borne by foreign investors, since once the crisis is considered finished, full compensation is due to them and the risks are shifted to host States, even if their economic situation may not be totally normal.[43]

The *LG&E* tribunal took this approach. Although the *LG&E* tribunal declared that the crisis met the requirements of Article XI and that no compensation was due to the investor during its duration,[44] the tribunal significantly narrowed the length of the necessity when calculating the damages due by Argentina to LG&E, in comparison with what the previous tribunal had determined in the *CMS* case.[45] Full compensation was calculated from the date the *LG&E* tribunal declared that the state of necessity had ceased to exist and Argentina should have started meeting its obligations to the investor, which it had not.

The definition of the length of the crisis is also important for the sharing of risks in another way: investors might be affected not by a single measure but by a set of measures adopted at different times. A narrow definition of the length of an economic collapse catches some measures, and States would not have to pay compensation on account of them, while the later-in-time measures would fall outside of the crisis, and investors would have to be fully compensated in respect of these latter measures.[46] This effect is clearly evidenced by the approach that the *CMS* and the *Continental* tribunals adopted in regards to the length of the Argentine collapse. The former embraced an expansive approach and extended the crisis up to early 2005. The latter, on the contrary, deemed that it had already ended in December 2004 and that, consequently, a measure affecting the claimant investor had been adopted at a time when the economy was already recovering, and therefore, Argentina could not get the benefit of the NPM clause of the Argentina – U.S. treaty. Had the *Continental* tribunal followed the *CMS* tribunal, the measure would have been covered and no compensation would have been owed to the investor.[47]

However, how to determine when a crisis has terminated? Political and economic criteria can be used for this purpose. The *LG&E* tribunal relied on a political criterion. According to it, Argentina's economic collapse terminated on April 26, 2003, when a new President was elected to replace the transitional authorities appointed by the Argentine Congress.[48] The use of this kind of parameter can be important to shorten the length of economic crises in the event of the successful invocation of a NPM clause. A well-

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43 The proposal has two caveats. The first is that the purpose is not to achieve an equal allocation of risks between host States and foreign investors when an NPM clause is successfully invoked. The second is that the proposal does not suggest that tribunals should *always* shorten the length of crises. It could be a tool to be used when tribunals apply the NPM clause and, in light of the particular facts and the investor's behavior, among other elements, are of the view that the requirements of justice demand some risk-sharing mechanism between the given claimant investor and the respondent host State. 44 *See LG&E Decision on Liability*, *supra* note 32, at para. 260.

45 The *LG&E* tribunal found the duration of the Argentine crisis to be much shorter than did the *CMS* tribunal. For the former, the crisis ran from December 1, 2001, until April 26, 2003, while for the latter, it ran from August 17, 2000, to some time at the end of 2004 or beginning of 2005. *See id.*, at paras. 226 – 29; *CMS Award*, *supra* note 15, at paras. 250.

46 *See Continental Award*, *supra* note 38, at paras. 159 & 220.

47 It is important to highlight a nuance in the approaches of the *CMS* and *LG&B* tribunals. The *CMS* tribunal ruled for the investor and expanded the length of the crisis in order to reduce the amount of compensation to be paid by Argentina. The expansion allowed the tribunal to allocate some costs on the investor. *See CMS* Award, *supra* note 15, at para. 446. On the contrary, the *LG&E* tribunal ruled for Argentina and, as was said, contracted the length of the crisis to transfer some costs to the State, since it did not owe any compensation during the extent of its economic collapse.

48 *See LG&E Decision on Liability*, supra note 32, at paras. 70 & 228.

recognized new element of political stability may be used to mark the conclusion of an economic collapse even if economic stability had not been achieved at the time but the political event was instrumental in putting the economy onto the path of recovery.[49]

But, in addition, there is a rich body of research in economics on the domain of a crisis' ending, based on the theory of business cycles,[50] on which arbitration tribunals and parties could rely. More sophisticated analyses based on economics give rise to new additional legal issues, but they could also lead to more informed decisions in this key area.

Economic research on the end of economic collapses is not uniform, as can be expected, and a detailed review of this research is beyond the scope of this article. However, for the purpose of the issue of the end of crises, it is important to look at two methodological approaches with two different legal implications in terms of allocations of risks between host States and foreign investors during severe economic breakdowns. [51]

The first one is to declare that a crisis has ended only once a certain criterion has reached its pre-crisis level. Reinhart and Rogoff deem that a crisis ends whenever an economy reaches "the prior peak in real per capita income."[52] This was the indicator and the level they used when they assessed the length of 100 financial crises around the world.

There is a second approach. Some economists have been cautious about making the return to a pre-crisis level as the parameter that signals the end of a crisis. For instance, Fatás and Mihov have illustrated that, if the length of the U.S. 1981 recession is measured by the time that the output gap took to reach its pre-crisis level, the output took 20 quarters to get there, when the fact is that the gap had been very close to zero after seven quarters. A similar situation took place, these authors claim, regarding the U.S. 1991 recession. The output gap took 25 quarters to get the pre-crisis level; however the gap was, again, close to zero after 7 quarters.[53]

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49 The *LG&E* tribunal is the only one that has so far relied on a political parameter to determine the termination of the Argentine crisis.

50 A well-known definition of business cycles was suggested by Burns and Mitchell in the following terms:
Business cycles are a type of fluctuation found in the aggregate economic activity of nations that organise their work mainly in business enterprises: a cycle consists of expansions occurring at about the same time in many economic activities, followed by similarly general recessions, contractions, and revivals which merge into the expansion phase of the next cycle; the sequence of changes is recurrent but not periodic; in duration cycles vary from more than one year to ten or twelve years; they are not divisible into shorter cycles of similar character with amplitudes approximating their own.
A. F. Burns,and W. C. Mitchell, *Measuring the Business Cycle,* New York: National Bureau of Economic Research (1946), at 1. *See* also Finn E. Kydland, and Edward C. Prescott *Time to Build and Aggregate Fluctuations*, 50 Econometrica 1345 (1982). For a general overview of the topic with ample discussion of the literature, *see* A. W. Mullineux, Business Cycles and Financial Crises (2011). at Chapter 2.

51 There are other issues to be considered, such as which criterion or criteria should be used to determine when a crisis ended. The use of different criteria might lead to different conclusions. For instance, Fatás and Mihov show this situation regarding the use of the output gap or the unemployment gap for the U.S. 1960 recession. If the unemployment gap is used to determine the length of this crisis, there was a quick recovery after four quarters, while if the output gap is used, the crisis lasted seven additional quarters, despite the fact that it was close to zero after the fourth quarter. *See* Antonio Fatás & Ilian Mihov, *Recoveries*. Paper presented at the annual economic conference at the Boston Federal Reserve on *Fulfilling the Full Employment Mandate*, April 12-13, 2013. at 17 - 20. http://faculty.insead.edu/fatas/Recoveries%20Fatas%20Mihov.pdf .
However, the present author is not concerned for the purpose of this article with what criteria are the most important to determine the end of an economic crisis. This is an issue that depends on the particular collapse in question. The present analysis is focused on a step further: once the criteria, if any, have been determined, when to declare that a crisis ended.

52 Carmen M. Reinhart & Kenneth S. Rogoff, *Recovery from Financial Crises: Evidence from 100 Episodes*, January 2014. NBER Working Paper No. 19823, at 4. http://www.nber.org/papers/w19823.pdf. Kannan, Scott and Terrones define the recovery and its length "as Number of quarters after trough and before recovery to the level of previous peak." Prakash Kannan, Alasdair Scott, and Marco E. Terrones, *From Recession to Recovery: How Soon and How Strong*, IMF World Economic Outlook April 2009, at 6 n3. https://www.imf.org/external/np/seminars/eng/2012/fincrises/pdf/ch8.pdf.

53 *See* Fatás & Mihov, *supra* note 51, at 17.

The legal implications of these two approaches in economics can be substantial for host States and foreign investors if the invocation of the NPM clause is successful. If a fixed level is chosen as a determinant of the end of a crisis, its length may be significant in the event of situations in which the given criteria have been close to their pre-crisis level for a certain period of time and on a consistent basis. In this case, the economy has recovered even if the chosen criteria have not reached their pre-crisis level. The full application of the Reinhart and Rogoff approach—that an economic collapse is deemed to have ended only when a particular criterion or criteria have reached their pre-crisis level—would mean that States would enjoy the benefits of the NPM clause and their zero compensation effect for longer periods of time: measures adversely affecting foreign investors adopted during this lapse of time would not violate the given BIT. Instead, under the approach suggested by Fatás and Mihov, crises end when the recovery trend becomes consistent, even if the given criterion has not reached the exact pre-crisis level.

The latter approach is the one suggested by the present author to introduce a risk-sharing mechanism between host States and foreign investors during economic collapses and in the event of the successful invocation of NPM clauses. These events should be deemed to have ended once the economy has started on a consistent path toward full recovery. Consequently, measures adopted by host States during this period should not get the benefit of the NPM clause even if the selected economic criteria have not totally reached their pre-crisis level, and compensation is owed to investors by host States. There was a glimpse of this approach in the *Continental* award. In it, the tribunal assumed that the crisis had virtually ended once Argentina had returned to the U.S. financial markets, which was evidence that its financial conditions "were evolving towards normality."[54]

In addition, when tribunals are relying on several criteria to determine when the crisis in question ended, tribunals should not declare the end of a crisis only after *all* of the criteria are on the path to reaching pre-crisis levels. Although one can expect that the criteria would be somehow interconnected in their evolution, not all of them will have the same dynamic.[55] Waiting for the last of them to be set onto a path to pre-crisis level would extend the length of the crisis more than is necessary, and States should not have the benefit of the zero compensation effect of NPM clauses when the economic climate has considerably improved and there is no significant risk involved.[56]

3.1. Risk-Sharing Mechanisms in "Double Dipping Crises"

Macroeconomic research has identified a certain situation not uncommon in economic crises that warrants particular attention when

54 *See Continental* Award, *supra* note 38, at paras. 159 & 221.n. 336.

55 Relying on the theory of business cycles, Rebelo illustrates the phenomena of comovement of different sectors of the U.S. economy regarding several criteria, such as gross output, value added, and materials and energy use. *See* Sergio Rebelo, *Real Business Cycle Models: Past, Present, and Future*. NBER Working Paper No. 11401. 19 – 21. June 2005. Comovement could also be at play during recoveries.

56 It has been shown how tribunals have disagreed on the length of the 2001 Argentinian economic collapse. (*See supra* note 45 and accompanying text). Despite the fact that the present author has suggested the use of research in economics on the end of economic crises, it is also important to highlight what one can expect from such use in terms of adjudication. The use of economic research can certainly refine each tribunal's decision on the end of a crisis, as a tool to create risk-sharing mechanisms. But this is not to say that one can expect consistency on a date for the end of a particular collapse by all investment tribunals applying NPM clauses regarding the same economic crisis. The use of research in economics posits its own challenges. Economists may and usually do disagree on the scope and accuracy of their models and on the reliability of the collected data, so the use of different economic models on the end of a crisis may well lead to determinations of different lengths of the same economic collapse. If economists may disagree on the dates, so may investor/State tribunals

narrowing the length of an economic collapse. In effect, Reinhart and Rogoff have shown that a significant percentage of financial crises in the United States have had what these economists call double dipping: a crisis began; an upturn in economic activity, which did not reach the previous peak, during a short period of time took place; and then the economy took a renewed downturn before it started recovering again and finally reached the pre-crisis peak.[57] In other words, there was a short-lived recovery that was not sustained. Reinhart and Rogoff treat the whole episode as a single crisis. However, as these authors highlight, their approach differs from another, in which instead of one crisis, economists regard that the given economy faced two crises separated by a period of time, the first upturn.[58] The key issue is how to treat those measures affecting foreign investors adopted during the first upturn.

Both approaches have different legal implications for States and investors. If a tribunal embraces the Reinhart & Rogoff approach, all of the measures adopted by a State during the short-lived upturn will be covered by the NPM clause and its zero-compensation effect. However, if the other approach is the one embraced, then the measures adopted sometime during the first upturn would have not been adopted during the time of necessity, and therefore, they would not be covered by the NPM clause. Thus, investors would have to be compensated in full for damages caused by measures adopted during most of the length of the first upturn.

It is certainly up to a tribunal, depending on the facts, the duration of the first upturn, and its degree, to make a decision in this regard, but a tentative analysis is worth making. The first upturn meant that the economy was just attempting to return to its pre-crisis level, and the fact that it was followed by a downturn meant that the economy, even at the time of the upturn, still faced significant risks. Thus, measures adopted during the first upturn should still be considered to have been necessary to overcome the given crisis in a more general sense. There would be, then, in principle, powerful reasons to regard that, during the short-lived recovery, the host State could still get the benefit of the NPM clause regarding measures adopted therein. As Reinhart and Rogoff suggest, the situation should be treated as a single crisis.

This assessment leads to the issue of how to narrow the length of a crisis in double-dipping economic collapses. As was said in Part 3 above, following Fatás and Mihov, tribunals should not wait to define the length of the crisis until the date the pre-crisis level was reached, but they could assume that the economy was not at grave risk at the time when the second upturn was strong and consistent in indicating a clear path to full recovery.

57 *See* Reinhart & Rogoff, *supra* note 52, at 4.
58 *See id.* at 4.

4. Conclusion

The ICSID case law on NPM clauses has transferred many of the risks during economic crises to investors. This article has put the case law in a broader context and shown that not all investors could be affected by it. New investors could respond and transfer risks to insurers by getting PRI or to host States by requiring *ex ante* a premium for the higher risks they are assuming during economic collapses. Old investors, on the other hand, may have been caught by surprise by the case law and been unable to react to it. It is for their benefit that novel ways to distribute risks during these episodes should be designed, when the demands of a broader sense of justice so require.

The article has explored the limits of Sykes' proposal of deferral of compensation. Based on the length of litigation arising from the 2001 Argentine crisis, the article has shown that, on one hand, awards can be expected to be rendered years after the end of crises and, on the other, that there is already a *de facto* suspension of compensation under the ICSID Convention. Thus, the deferral of compensation as a potential way to introduce an element of risk sharing between host States and foreign investors during economic crises becomes necessary only in exceptional circumstances, and it is unable to be of general application. Host States could generally afford to pay compensation owed to investors during economic collapses. In any case, Sykes' proposal of compensation to investors and its bases in law and economics remains potentially important for non-ICSID tribunals applying NPM clauses, but unlikely—in principle—to change the course of the ICSID case law. This seems to have set a defined course not altered by States' subsequent practices or treaties.

Thus, other risk-sharing formulas should be explored within the scope of the ICSID case law when an NPM clause is successfully invoked, and the present article puts forward one: shortening the length of the crisis. This is an important tool to allocate risks between investors and host States. By virtue of the operation of the clause, setting the period between the start and end dates of the crisis at the shortest length possible *while accepting the severity of the crisis* allows tribunals to alleviate the burden of the risks borne by foreign investors, since once the crisis is considered finished, full compensation is owed to them and the risks are shifted to host States, even if their economies may not have returned to normality. The article has expanded the analysis of this proposal on the basis of the literature in economics on how to determine the end of economic collapses. The article has presented two leading perspectives and shown their impact on States and investors if applied in the context of litigation in which the invocation of an NPM clause has been successful. The article has concluded that the end of a crisis should not be declared to exist only after a certain economic parameters have reached their pre-crisis level, as some prominent economists suggest, but once such indicators have become consistently close to this level. The article has also assessed the event of double dipping crises as defined by the economic literature and agreed that these collapses should be treated as a single event, in which States should get the benefit of the NPM clause even regarding measures adopted during the short lived recovery.