

Looking for Legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration

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1. Introduction

Decisions by adjudicators involving judicial review that prove to be controversial among stakeholders are often faced with legitimacy-related criticism.¹ This is the core of the so-called counter-majoritarian difficulty,² i.e. the problem of justifying judicial review of democratically enacted measures and legislation by nondemocratic adjudicative bodies.³ In international relations, the same problem is at issue, only in an intensified version.⁴ With the massive proliferation of international courts and tribunals of the last years,⁵ as well as the corresponding trend towards what has been called the “legalization”⁶ or “juridification”⁷ of world politics—what critics call ‘global legalism’⁸—this phenomenon is only likely to increase.

Recently, the political scientist Alec Stone-Sweet has argued that the field of investment treaty arbitration is undergoing a similar process.⁹ In this field—composed of a web of nearly 3000 specialized bilateral and a few regional treaties that provide a venue for third-party dispute resolution for foreign investors against home states for a variety of claims—the

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¹ For a classic discussion, see e.g. J. Skelly Wright, “The Role of the Supreme Court in a Democratic Society - Judicial Activism or Restraint?” 54 *Cornell Law Review* (1968) 1. For a discussion of the vast literature on the subject see Mauro Cappelletti, “Repudiating Montesquieu? The Expansion and Legitimacy of “Constitutional Justice” in Mauro Cappelletti (ed.), *The Judicial Process in Comparative Perspective* (Clarendon Press 1989) 182 - 211.

² The phrase was coined by Alexander Bickel, *The Least Dangerous Branch: The Supreme Court at the Bar of Politics* (The Bobbs-Merrill Company 1962) 16 *et seq.*

³ Kenneth D.Ward, “Introduction” in Kenneth D.Ward and Cecilia R.Castillo (eds.), *The Judiciary and American Democracy: Alexander Bickel, The Counter-majoritarian Difficulty, and Contemporary Constitutional Theory* (State University of New York Press 2005) 1-7

⁴ Andreas Follesdal, “The Legitimacy of International Human Rights Review: The Case of the European Court of Human Rights” 40 *Journal of Social Philosophy* (2009) 595-607, 596. Here, Follesdal reviews (and rebuts) several well-known criticisms against judicial review.

⁵ See e.g. Ruth Mackenzie, Cesare Romano, Yuval Shany with Philippe Sands, *The Manual on International Courts and Tribunals* (Oxford University Press 2nd edition 2010) x; Chester Brown, *A Common Law of International Adjudication* (Oxford University Press 2007) 17-23.

⁶ Judith Goldstein et al, ‘Introduction: Legalization and World Politics’ 54 *International Organization* (2000) 385-399.

⁷ Lars Chr. Blichner and Anders Molander ‘Mapping Juridification’ 14 *European Law Journal* (2007) 36-54. The authors note that juridification, judicialization and legalization in this context are used as synonyms.

⁸ Eric Posner, *The Perils of Global Legalism* (Oxford University Press 2010)

⁹ Alec Stone-Sweet, “Investor-State Arbitration: Proportionality’s New Frontier” 4 *Law & Ethics of Human Rights* (2010), available at <http://www.bepress.com/lehr/vol4/iss1/art4>.

controversy, concerning judicial review by unaccountable arbitrators of governmental acts, has been no less vivid.¹⁰ On the forefront of the debate have been disputes pitting reputedly bona fide regulatory activities for environmental purposes by governments against transnational companies as well as the legal consequences of claims raised by (mainly) American investors in connection with the emergency measures Argentina took during its economic crisis in 2001–02.¹¹ Recently, a statement by 31 academics “with expertise relating to investment law, arbitration, and regulation” recommended *inter alia* that states should review their existing investment treaties and that the “international business community should refrain from promoting the international investment regime and from resorting to investment treaty arbitration”.¹²

Adjudicators might respond to such criticism in many different ways,¹³ e.g. by way of adopting interpretative strategies better fitted for the purpose. Still, the best bet seems to be to minimize the likelihood of such criticism appearing in the first place. In that sense, proportionality analysis might serve courts and tribunals as a tactical maneuver with powerful strategic capabilities.

Correspondingly, adjudicators worldwide have employed such analysis more and more often over the last sixty years.¹⁴ International judges and arbitrators, too, have embraced the technique and it is now a common feature of almost any international dispute settlement mechanism.¹⁵

Investment treaty tribunals have recently begun conducting some forms of proportionality analysis as well, though, in my view with mixed success so far. Although an element of balancing can be found in several awards in discussions of standards that prohibit unreasonable, arbitrary or discriminatory measures,¹⁶ or that require fair and equitable treatment,¹⁷ in this paper I focus on explicit proportionality reasoning by tribunals, which is usually accompanied by the citation of jurisprudence from international adjudicators external to the investment treaty regime. It is suggested that the emergence of these types of

¹⁰ See generally e.g. Michael Waibel *et al* (eds.), *The Backlash Against Investment Arbitration* (Kluwer 2010).

¹¹ See e.g. Louis T. Wells, “Backlash to Investment Arbitration: Three Causes” in Waibel *et al*, *supra* n. 10, 340-352; and William Burke-White, “The Argentine Financial Crisis: State Liability under BITs and the Legitimacy of the ICSID System” Waibel *et al*, *supra* n. 10, 407-432.

¹² Public Statement on the International Investment Regime, 31 August 2010. Available at

http://www.osgoode.yorku.ca/public_statement/

¹³ For an excellent discussion of some of the possible responses, see Anthea Roberts, “Power and Persuasion in Investment Treaty Arbitration” 104 *American Journal of International Law* (2010) 176-225.

¹⁴ Iddo Porat, “Some Critical Thoughts on Proportionality” in Giovanni Sartor, Giorgio Bongiovanni and Chiara Valentini (eds.), *Reasonableness and Law* (Springer 2009) 243-250, 243 who dubs the diffusion of proportionality “an amazing phenomenon, both in terms of its scale and in terms of the rapidity and the relative ease by which it has come about.”

¹⁵ Alec Stone Sweet and Jud Mathews, “Proportionality Balancing and Global Constitutionalism” 47 *Columbia Journal of Transnational Law* (2008) 73-165.

¹⁶ See e.g. *LG&E*, Decision on Liability, 3 October 2006, para. 158; *BG Group Plc v. Argentina*, UNCITRAL (UK/Argentina BIT). -Award, 24 December 2007 para. 339 *et seq.*

¹⁷ E.g. *Saluka* partial award 2006 para. 306 and, most recently and more directly, *Total v. Argentina* (27 December 2010 (ICSID)) (France-Argentina BIT). The latter, in which proportionality analysis seems to have been more important in the fair and equitable treatment analysis, will be discussed briefly toward the end of this paper.

proportionality analysis should be seen in light of the putative “legitimacy crisis in investment treaty arbitration”.¹⁸

While much has been written about legitimacy in investment treaty arbitration,¹⁹ surprisingly few scholars have looked into tribunals’ use of proportionality analysis.²⁰ As far as the present author is aware the cases discussed in some depth below have not been examined together for these purposes. As such, this paper serves as a “prolegomenon” to a study of proportionality analysis in investment treaty arbitration. Its chief claim to importance lies in the strengthening of ideas related to the relationship between the legitimacy of judicial review and modalities of legal reasoning, applied to the setting of a maturing international legal regime.

This paper, which is part of a larger study of proportionality analysis in investment treaty arbitration, continues in the following manner. Part 2 introduces the idea of legitimacy in international adjudication and explains why it is a crucial quality of the system through which states regulate their interaction with each other and with the other actors at the international level. Then, in Part 3, follows a brief examination of proportionality analysis, before I analyze and criticize its application by treaty tribunals in the most prominent cases so far in Part 4. The final Part sums up the argument and concludes that whereas there is little reason to believe in anything but continued usage of proportionality analysis it is uncertain whether the paths taken by treaty tribunals here explored are likely to be taken again.

2. Institutional and procedural legitimacy in investment treaty arbitration

“When it comes to legitimacy,” Laurence Tribe a few years back concluded that all has already been said, “and what has been said is all so deeply riddled with problems that it seems hardly worth restating, much less refuting or refining.”²¹ That does not seem to be the case in international legal writing, although the description of a “veritable renaissance of international legitimacy talk over the past decade” might be accurate if international relations scholars and political scientists are included.²² From a conventional international law perspective, it is presumably safe to conclude that State consent is the ultimate source of legitimacy for any international adjudicative body, although it certainly is not the only one.²³

¹⁸ Referring to the title of a much cited article on the topic, Susan D. Franck, “The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions” 73 *Fordham Law Review* (2005) 1521.

¹⁹ See e.g. the various papers in Waibel *et al*, *supra* n. 9 and the references in n. 6 in Stephan Schill Charles N. Brower, “Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?” 9 *Chicago Journal of International Law* (2009) 471-499.

²⁰ There are a few isolated studies. See e.g. Han Xiuli, “The Application of the Principle of Proportionality in *Tecmed v. Mexico*” 6 *Chinese Journal of International Law* (2007) 633-352; Benedict Kingsbury and Stephan Schill, “Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law” *IILJ Working Paper* 2009/6 (Global Administrative Law Series) Finalized 08/19/2009 (www.iilj.org) and Alec Stone-Sweet, *supra* n. 7.

²¹ Laurence H. Tribe, *Constitutional Choices* (Harvard University Press 1985), 3.

²² Ian Clark, *Legitimacy in International Society* (Oxford University Press 2005) 12.

²³ For summary of criticism against this point, see Rüdiger Wolfrum, ‘Legitimacy in International Law from a Legal Perspective: Some Introductory Considerations’ in Rüdiger Wolfrum and Volker Röben, (eds.), *Legitimacy in International Law* (Springer 2008) 1–24, 10–19

At the establishment stage of any international regime,²⁴ as well as when non-participating states consider joining it, other sources of legitimacy, such as widespread participation and a just purpose, come into play. Consequently, if governments are to be convinced of as giving their consent to regulatory regimes, the perception of legitimacy is also an essential precondition for consent.²⁵ Legitimacy is therefore vital to any effective treaty regime, but it can be lost. If a treaty regime, such as that of investment treaty arbitration,²⁶ systematically provides consequences contrary to expectations of fairness among the stakeholders—for example if important environmental concerns are always or almost always trumped by the interests of foreign investors in the decisions of arbitral tribunals, or even if there is a perception that this is the case—the long-term consequence can prove harmful to the legitimacy of the treaty regime.²⁷ As a corollary, the legitimacy of the regime is requisite for ensuring the actors' compliance with it and even the prevention of denunciation.²⁸ This notion of exit from a treaty regime, furthermore, is in itself related to legitimacy because '[t]he higher the number of exiting states, the greater the damage to the system's credibility and viability.'²⁹ With this in mind courts and tribunals (like IOs in general) seek to create and maintain their legitimacy and independence when exercising their tasks. As Garret and Weingast put it,

'[c]ourts whose rulings are consistently overturned typically find themselves and their role in the political system weakened. As a consequence, the actions of the courts are fundamentally 'political' in that they must anticipate the possible reactions of other political actors in order to avoid their intervention.'³⁰

It is to avoid these reputational costs and their possible consequences that courts and tribunals want their decisions and argumentative practices to “remain in the area of acceptable latitude.”³¹ For institutions embedded within the effective functioning of a legal regime, such as international courts and tribunals, these perceptions of legitimacy may protect institutions ‘from abolishment or fundamental alterations of’ their role as adjudicative bodies.³² Viewed

²⁴ I am using the terminology of Simma and Pulkowski. Bruno Simma and Dirk Pulkowski, “Of Planets and the Universe: Self-Contained Regimes in International Law” 17 *The European Journal of International Law* (2006) 483-529.

²⁵ Alan Boyle and Christine Chinkin, *The Making of International Law* (Oxford University Press 2007) 25. This might seem like a perfect tautology, but the latter points to

²⁶ For a recent application of regime theory to international investment law, see Jeswald W. Salacuse *The Law of Investment Treaties* (Oxford University Press 2010) 5-16. One might ask to what extent there is any difference between calling the object a “regime” or a “system”. For the latter terminology, see e.g. Gus van Harten, *Investment Treaty Arbitration and Public Law* (Oxford University Press 2007) 3-6. At any rate, it seems to me somewhat difficult to reconcile Krasnerian regime-theory with doctrinal international legal scholarship, as Salacuse appears to do (citing Stephen D. Krasner, “Structural Causes and Regime Consequences: Regimes as Intervening Variables” in Stephen D. Krasner (ed.), *International Regimes* (Cornell University Press 1983)). Similarly: Asha Kaushal, ‘Revisiting History: How the Past Matters for the Present Backlash Against the Foreign Investment Regime’ 50 *Harvard Journal of International Law* 491-534, 492.

²⁷ See Nienke Grossman, ‘Legitimacy and International Adjudicative Bodies’ 41 *The George Washington International Law Review* 101–174, 138–139 and Thomas Franck, *Fairness in International Law* (Oxford University Press 1995)

²⁸ The connection between denunciation and legitimacy in the context of investment treaty arbitration is made also by Grossman, *supra* n. 27, 101–102.

²⁹ Anthea Roberts, *supra* n.13, 191.

³⁰ Geoffrey Garret and Barry R. Weingast, “Ideas, Interests and Institutions: Constructing the EC’s Internal Market” in Judith Goldstein and Robert Keohane, (eds.), *Ideas and Foreign Policy* (Cornell University Press 1993) 173-206, 200.

³¹ *Ibid*, 201.

³² Grossman *supra* n. 27, 103.

from within a particular international regime,³³ legitimacy is the shield with which an institution wielding neither the purse nor the sword might project and preserve its power.

By ‘legitimacy’, I mean here a concept relating to the ‘justification and acceptance’ of the authority exercised by arbitral tribunals by virtue of an international investment treaty between states.³⁴ More specifically, I am interested in the perceived legitimacy of the outcome of the authority exercised by arbitral tribunals. This perception is, it is argued, a contributing factor to the legitimacy of the investment treaty arbitration regime as a whole.³⁵ In other words, an actors’ perception that adjudicative decision making, including interpretation and application, is conducive to its own preferences increases the likelihood that it regards the adjudicative body and that body’s decisions as imbued with justified authority.³⁶ This legitimacy, in some degree, is one of the conditions for initial commitment and continued consent to as well as compliance with—and hence the existence of—the regime as a whole.³⁷

Structurally, the concept of legitimacy in international investment law can be seen as a condition that might exist in three different, yet inter-related, co-dependant spheres.³⁸ The first is the governmental sphere,³⁹ the second is the civil society sphere, composed of NGOs and

³³ As seen in the discussion of judicial review below.

³⁴ Daniel Bodansky, ‘The Concept of Legitimacy in International Law’ in Rüdiger Wolfrum and Volker Röben, (eds.), *Legitimacy in International Law* (Springer 2008), 309-317, 310

³⁵ Rüdiger Wolfrum, “Legitimacy in International Law from a Legal Perspective: Some Introductory Considerations” in Wolfrum and Röben, (eds.), *supra* n. 34, 1–24, 7.

³⁶ Grossman, *supra* n. 24, 115.

³⁷ This incorporates both a ‘static’ form of consent (with respect to individual investment treaties) as well as a dynamic meaning (with respect to the regime of international investment law as such), because international investment law is in my view something more than the sum of almost 3000 BITs. For the idea of ‘static’ and ‘dynamic’ consent, see Wolfrum, *supra* n. 33, 8. There are of course many other factors affecting state consent to and compliance with international legal rules, see e.g. Moshe Hirsch, “Compliance with Investment Treaties: When are States more Likely to Breach or Comply with Investment Treaties?” in Christina Binder et al (eds.), *International Investment Law for the 21st Century* (Oxford University Press 2009) 865-876, 868. With respect to the investment treaty awards concerning Argentina, discussed *infra*, it should be mentioned however, that the so-called Rossati Doctrine—named after Argentina’s Minister of Justice Horacio Rosatti—implies that awards that ‘confers a higher status on a foreign investor than on an Argentinian investor’ would be in violation of the Argentinian Constitution. Referred in Christopher F. Dugan et al, *Investor-State Arbitration* (Oxford University Press 2008) 703. See also Anthea Roberts *supra* n.13, at 193 with further references.

³⁸ This is not to be confused with, but is strongly related to what Putnam has called a two-level game. In his terminology the three spheres mentioned here corresponds to the second level, where domestic politics impose constraints on one (but not the other) party to international negotiations. Robert D. Putnam. "Diplomacy and Domestic Politics: The Logic of Two-Level Games." 42 *International Organization* (1988) 427-460, 434. As Grossman observes, legitimacy is ‘agent relative’ because ‘states are neither the sole actors in the international realm nor unitary actors, and their preferences may be shaped by a number of constituencies. These constituencies may include domestic political parties, voters, elites, domestic and international nongovernmental organizations (NGOs) and private parties. The decision to grant continuing consent depends on the perceptions of any given actor who might influence or determine state preferences.’ Grossman, *supra* n.27, 110. One example indicative of this type of preference shaping processes in this context was seen when Norway’s Model BIT was put on hold in 2008, allegedly because of political pressure by NGOs upon the Norwegian Left-Centre Coalition Government. Damon Vis-Dunbar, ‘Norway shelves its draft model bilateral investment treaty’ *Investment Treaty News* 8 June 2009.

³⁹ Which, again, may be divided into executive and legislative, even though this distinction is not equally important in all systems of government. See e.g. Helen V. Millner, *Interests, institutions, and information: domestic politics and international relations* (Princeton University Press 1997) chapter 2; and Oluf Langhelle and Hilmar Rommetvedt, ‘The role of parliament in international relations and WTO negotiations: the case of Norway’ 3 *World trade review* (2004) 189-223.

individuals,⁴⁰ and the third is the investors, usually multinational enterprises.⁴¹ Each of these spheres represents diverging interests, values and approaches.⁴² The connection in this respect between these three spheres is that they reflect (some of) the various strata that shape state interests toward a preference equilibrium at which point commitment might be a likely strategic outcome of intra-state interactions.⁴³ However, this preference-equilibrium can be altered by exogenous forces, such as the behaviour of the institution in question, or interpretation of a norm by an international adjudicator that is sufficiently at odds with what the actors initially had expected.⁴⁴ Or, as Grossman puts it, stressing the dynamic element, ‘perceptions of legitimacy may change over time’⁴⁵ e.g. when actors alter their views of the legitimacy of an international adjudicator after it has issued a particular decision, in particular if ‘a state consented in a treaty ratified many years before a concrete case arose’ and the decision by the international adjudicator involves interpretation sufficiently at odds with initial state preferences.⁴⁶

Furthermore, because of the connection between the formation of state preferences and legitimacy as a condition in different spheres, sufficiently strong resentment against international norms and institutions in one sphere, e.g. civil society, cannot remain unaddressed to sufficiently large extent for a long time. If it is, the legitimacy, and hence the states’ willingness to present behavior compliant with the regime, or even their willingness to

⁴⁰ Governments may value sovereignty and consent above participation and transparency, whereas civil society may prefer the latter to the former. Consequently, ‘factors that may help to legitimize an institution in the eyes of non-state actors may help to delegitimize it in the eyes of state-actors.’ Bodansky, *supra* n. 34, 314.

⁴¹ Note that this points to the reciprocal element of investment treaty arbitration. If the outcomes of arbitration under such treaties systematically went against the interests of foreign investors, presumably mainly capital exporting states would not be interested in providing consent to treaties that might also be employed against them.

⁴² Todd Sandler, ‘Treaties: Strategic Interactions’ 1 *University of Illinois Law Review* (2008)155–180, 159.

⁴³ Preferences shaped at Putnam’s second level, with parties interacting at his first level. Putnam, *supra* n. 38. Recent shifts of power in global politics which have seen, among other changes, investment treaties being concluded not only between (mainly) capital exporting and (mainly) capital importing states presumably makes this metaphor less apt. See Americo Beviglia Zampetti and Pierre Sauvé, ‘International Investment’ in Andrew T. Guzman and Alan O Sykes (eds.), *Research Handbook in International Economic Law* (Edvard Elgar 2007) 211-270, 215. For an account of domestic impact on such negotiations, see Ahmer Tarar, ‘International Bargaining with Two-Sided Domestic Constraints’ 45 *Journal of Conflict Resolution* (2000) 320–340. It is assumed that essentially the same game is played out (continuously reiterated) with respect to decisions on continued commitment and compliance (though with the legislative branch being less significant because its most important role in this context is ratification) and (though less explicitly so) in principle also with respect to less conspicuous methods available for states to influence ex post the substance of their international legal commitments such as the generation of subsequent state practice in the respect of Article 31 (3) (a), (b) of the VCLT. On this method as a legitimacy enhancing measure, see generally Roberts, *supra* n.13. See also e.g. the 2005 US–Uruguay BIT, Annex E, ‘Within three years after the date of entry into force of this Treaty, the Parties shall consider whether to establish a bilateral appellate body or similar mechanism to review awards rendered under Article 34 in arbitrations commenced after they establish the appellate body or similar mechanism.’ Similarly, the three spheres I operate with are obviously not represented equally among all states. To the extent that they are not, a simplified assumption of arbitral tribunals navigating a binary of host state versus foreign investor interests should not necessitate altering the argument.

⁴⁴ This is related to modes of interpretation. The ECtHR is often criticized for its ‘dynamic’ or ‘evolutive’ interpretation. Paul Mahoney, ‘Judicial Activism and Judicial Self-Restraint in The European Court of Human Rights: Two Sides of the Same Coin’ 11 *Human Rights Law Journal* (1990) 57; and Laurence R. Helfer ‘Consensus, coherence and the European Convention of Human Rights,’ 26 *Cornell International Law Journal* (1993) 133–165

⁴⁵ Grossman *supra* n. 27 , 111.

⁴⁶ *Ibid.*

maintain their consent to it, risk being compromised.⁴⁷ For, even though non-compliance is costly and denunciation even more so, states can ‘attack the legitimacy of particular investment tribunals or the system as a whole, either unilaterally or collectively.’⁴⁸ If state behavior that is not compliant with the requirements of an international regime is at *their* peril,⁴⁹ long-time non-adherence to states’ legitimacy concerns are ignored at the risk of international adjudicators.⁵⁰ As a consequence, international adjudicative behavior ‘is constrained by the preferences of states’.⁵¹ In addition, and in contrast with other international adjudicative forums that provide individuals with access to litigation, such as human rights courts, investment treaty arbitrators are constrained by the preferences of investors in their dual role as preference shapers of capital exporting state and as part of the process.⁵²

I. Why do international adjudicators care about their legitimacy?

As Georg Vanberg has shown, domestic judges are to some extent constrained by public opinion, and this factor exerts influence on their strategic behavior within structural and legal constraints.⁵³ In this connection, Ginsburg has argued that ‘[d]omestic judges would seem to be more constrained than international judges, for they operate within constitutional systems that provide strategic limitations on lawmaking.’⁵⁴ However, most domestic judges are

⁴⁷ For examples, see Part 2.II below.

⁴⁸ Roberts *supra* n.13, 193.

⁴⁹ *Ibid.*

⁵⁰ States employ international law strategically, but international adjudicators may be regarded less as agents of states than as trustees, see Alter, *supra* n.44. They have wide discretionary powers in this sense, but this discretion is not unlimited. Tom Ginsburg, ‘Bounded Discretion in International Judicial Lawmaking’ 45 *Virginia Journal of International Law* (2005) 631.

⁵¹ *Ibid.*, 632.

⁵² As well as by other norms. Grossman argues persuasively that ‘reputational costs may be high for a judge or arbitrator who strays too far from the normative mainstream or is perceived as making decisions based on personal proclivities, and such decisions may endanger her and the institution’s likelihood of being called upon to render future decisions.’ Grossmann *supra* n. 128. This is not a theoretical concern. On August 10, in the *Ad Hoc* Annulment Committee decision of *Vivendi v. Argentina*, the claimant argued that one of the arbitrators of the original Tribunal ‘was acting as a Member of the Board of Directors, Chairperson of the Nominating Committee and Member of the Corporate Responsibility Committee of the Swiss bank UBS, one of the largest and most influential institutions in the world, she was simultaneously serving as an arbitrator appointed by CAA and Vivendi in cases against the Argentine Republic. UBS held shares in Vivendi with voting rights valued at approximately €477,000,000 (2,38% of € 20.044 billion). At that time, UBS was the single largest shareholder in Vivendi’ (Internal footnotes omitted.). *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic* (ICSID) (Annulment Proceedings) Decision on the Argentine Republic’s Request for Annulment of the Award rendered on 20 August 2007, 10 August 2010, para. 20. The *Ad Hoc* Committee criticized the arbitrator, but did not find that this was sufficient grounds for annulment. Similarly, a prominent arbitrator was recently proposed disqualified by claimant upon the ground that her multiple appointments by Venezuela gave rise to objective and justifiable doubts regarding her independence and impartiality. *Tidewater Inc. and others v. Bolivarian Republic of Venezuela* (ICSID Case No. ARB/10/5), Decision on the Proposal for the Disqualification of a Member of the Arbitral Tribunal (December 23, 2010). The proposal was not accepted by the other arbitrators.

⁵³ Georg Vanberg, *The Politics of Constitutional Review in Germany* (Cambridge University Press 2004) 124–130. For a primer on judicial strategic behaviour, see e.g. Pablo T. Spiller and Rafael Gely, ‘Strategic Judicial Decision-Making’ in Keith E. Whittington, R. Daniel Kelemen and Gregory A. Caldeira, (eds.) *The Oxford Handbook of Law and Politics* (Oxford University Press 2008) 34–45.

⁵⁴ Ginsburg, *supra* n.50, 633.

embedded actors within the system that constitutes the state, whereas States at any time might opt out of international regimes.⁵⁵

At any rate, I claim, in line with Ginsburg, that international judges (and arbitrators) too are strategic actors.⁵⁶ For international adjudicators without tenure—and international arbitrators, who are selected on an ad-hoc basis, in particular—these concerns about the opinions of the indirectly represented actors, the agents of which they are set to adjudicate against,⁵⁷ materialize along a different axis, yet they are no less important. Because they are appointed by the parties to the dispute,⁵⁸ usually one state and one investor,⁵⁹ arbitrators can afford to ignore the interests of neither.⁶⁰

This multi-party consent to the investment treaty arbitration regime might be sustained through the appropriate application of legal techniques that contribute to its legitimacy. For adjudicators (and treaty-makers) this means that all the addressees, in a broad sense, of the regulation must be included. This is because a central determinant of the legitimacy of adjudicative decisions is fairness-related in the sense that should not be perceived to systematically favour one interest over another.⁶¹

One particularly salient feature of the investment treaty arbitration regime is that this legitimacy must be strengthened through mechanisms that take into account not only the interests of the state parties to the treaty and their various sub-branches in government and other preference shapers, but also the potential claimants, i.e. foreign investors, which, as noted above, therefore constrain adjudicative behaviour. If the foreign investors do not perceive the system to be legitimate, they are not likely to trust it. This might result in a decline in the (putative) efficiency of the investment treaty regime in terms of achieving the desired regime outcome, i.e. it might have a negative effect on the expected contribution to State party FDI.⁶²

⁵⁵ And there are many sophisticated ways to exit. Ginsburg is definitely aware of this and devotes a substantial part of the article to a thorough analysis of this idea. For examples, see *infra* Part 2.II.

⁵⁶ Ginsburg, *supra* n. 50, noting that '[b]ecause judicial review is the exercise of an interdependent lawmaking power, courts ultimately behave strategically.' 657. As we shall see below, this is precisely the type of adjudicative behaviour we are concerned with here.

⁵⁷ This argument rests on the assumption of a 'chain of delegation'. See Kaare Strom, "Parliamentary Democracy and Delegation" in Kaare Strom, Wolfgang C. Müller and Torbjörn Bergman (eds.), *Delegation and Accountability in Parliamentary Democracies* (Oxford University Press 2006) 55-106.

⁵⁸ See e.g. Article 37(2)(b) of the ICSID Convention.

⁵⁹ The parties then either agree on the third arbitrator or delegates the appointment of the third arbitrator to some third-party, e.g. the ICSID Secretariat. See e.g. Art. 4(2) of the ICSID Rules. Available at: <http://icsid.worldbank.org/ICSID/ICSID/RulesMain.jsp>

⁶⁰ See Charles N Brower and Stephen W. Schill, 'Is Arbitration a Threat or a Boom to the Legitimacy of International Investment Law' 9 *Chicago Journal of International Law* (2009) 471-498, 492 noting that '[i]t is rather his or her reputation for impartial and independent judgment that earns appointments. Reputation is difficult to build up and is easily destroyed; these characteristics thus work against any incentive to taint one's decision making in favor of either party in order to secure future appointments.'

⁶¹ Michael Zürn: 'Introduction: Law and compliance at different levels', in Michael Zürn and Christian Joerges (eds.), *Law and Governance in Postnational Europe: Compliance beyond the Nation-State* (Cambridge University Press 2005) 26

⁶² The question whether BITs contribute to a State's FDI has been the subject of considerable scholarly debate. While it is not necessary to address this question in any detail here, I refer to a very recent meta-analysis in which it was concluded that "the more sophisticated studies confirm a positive link between BITs and FDI." Jan Peter Sasse, *An Economic Analysis of Bilateral Investment Treaties* (Gabler Verlag 2011) 73.

How can the interests of the involved parties be accommodated by the arbitral tribunal? The most notable example is the outcome of the cases. Put briefly, the outcome of a case is likely to be regarded as legitimate if the decision is made in an even-handed, fair and just manner as well as providing consequences not too much at odds with what is expected by the stakeholders. This being said, not only the outcome of the specific decisions but also tribunals' reasoning must be considered legitimacy-wise. Since international investment agreements mainly regulate the behavior of the state parties rather than the behavior of the investors—and since arbitral tribunals consequently are charged primarily with the task of reviewing the acts or omissions of a State—it is the manner in which arbitral tribunals consider such acts or inactions that can contribute to the legitimacy of the decisions they make. This is where proportionality analysis becomes relevant in the context of legitimacy and it is, as we shall see, in this context precisely it has been employed in investment treaty arbitration.⁶³

II. *Legitimacy concerns in investment treaty arbitration*

In May 2007 Bolivia, as the first country ever, withdrew from the ICSID Convention.⁶⁴ Venezuela has declared it will follow suit.⁶⁵ 30 April 2008 it gave the Netherlands formal notice that it would terminate the Venezuela–Netherlands BIT.⁶⁶ There were probably several reasons for this action, including popular resentment and a domestic political situation in many countries in which opposition by some Latin American countries against the system of investment treaty arbitration similar to the one seen in the 1970s has flourished.⁶⁷ In addition

⁶³ Sadurski and others have observed that when balancing between competing values judges are engaged in an activity very similar to lawmaking. This in itself could entail legitimacy critique in the sense that I have outlined here. As a consequence, proportionality analysis is best suited to review where the structure of the legal basis allows for a limitation of a right. Wojciech Sadurski, “Reasonableness and Value Pluralism in Law and Politics” in Sartor *et al* (eds.), *supra* n. 14, 129-146, 135, 138-140. I do not disagree with this, but as we shall see below, for the investment awards discussed in this paper —where the structure admittedly was rather different from the right-limitation model found in most international human rights and trade treaties and modern constitutions—alternative approaches had already faced much objection by scholars and others.

⁶⁴ See ‘Bolivia Submits a Notice under Article 71 of the ICSID Convention’, *ICSID News Release*, May 16 2007. Article 71 of the ICSID Convention reads:

‘Any Contracting State may denounce this Convention by written notice to the depositary of this Convention. The denunciation shall take effect six months after receipt of such notice.’ The denunciation became effective on 3 November 2007. See generally e.g. Oscar M. Garibaldi, “On the Denunciation of the ICSID Convention, Consent to ICSID Jurisdiction, and the Limits of the Contract Analogy” in Christina Binder *et al* (eds.), *supra* n. 44, 251-277; Keyvan Rastegar, “Denouncing ICSID” in Binder *et al*, 278-301; The countries rebutted thereby, perhaps, the implication of Professor Muchlinski’s claim in a book published earlier that year that some of the benign characteristics of the Convention have proved so successful that an increasing number of states formerly opposed to it now has accepted its jurisdiction; in particular, he emphasizes, ‘the smaller Latin American countries’, Peter Muchlinski, *Multinational Enterprises and the Law* (Oxford University Press 2nd edition 2007) 746. At the time of writing, 17 cases are pending against Venezuela alone under ICSID.

⁶⁵ But it is currently listed as a State party on ICSID’s website (reportedly accurate as per 27 December 2010). <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ContractingStates&ReqFrom=Main>

⁶⁶ Luke Eric Peterson: ‘Venezuela surprises the Netherlands with termination notice for BIT’ 1 *Investment Arbitration Reporter* (No. 1) 16 May 2008. Reportedly, the BIT was incompatible with its ‘national policy’ governing investments. The treaty was employed as an investment protection vehicle by several multinational energy investors.

⁶⁷ The claim to permanent sovereignty over natural resources, an important legal aspect of the ‘New International Economic Order’ was proposed by Chile. Oscar Schachter, “International Law in Theory and Practice” 178 *Recueil des Cours* (1982) 1-395, 296. On the role of ideologies, see Muchlinski, *supra* n.64, 90–96.

to ICSID, Bolivian President Evo Morales was quoted by The Washington Post as denouncing ‘legal, media and diplomatic pressure of some multinationals that ... resist the sovereign rulings of countries, making t[h]reats and initiating suits in international arbitration.’⁶⁸ Similarly, on November 23, 2007, the Ecuadorian government notified ICSID that it would not accept its jurisdiction in cases stemming from disputes over nonrenewable resources,⁶⁹ and then submitted its notice of denunciation in 2009, which in accordance with Article 71 of the ICSID Convention took effect early 2010.⁷⁰ India, meanwhile, has chosen to omit key treaty protections from its Economic Cooperation agreement with Singapore.⁷¹

These events, as Asha Kaushal has noted, took place against the background of several investment treaty arbitration awards being rendered against Argentina and the measures it took in order to counter the economic crisis of 2000–02.⁷² The crisis was caused by what is still a record high default on sovereign debt (totaling more than \$ 95 billion),⁷³ which forced the country to devalue and then float the peso, which had been pegged to the dollar.⁷⁴ As most savings, loans and contracts were in dollars, the devaluation added to the financial chaos. Many governmental functions, particularly in the utilities sector, had been privatized and were operated by foreign companies with contracts in dollars that were now devaluated. This led to a series of claims from foreign investors under bilateral investment treaties, customary international law and Argentine law and in many different legal forums. Here, we are concerned with those that might be regarded as part of the investment treaty arbitration regime.⁷⁵

In many of these cases, as we shall see, the very concept of ‘economic crisis’ was of central importance. The legal questions centered inter alia on whether the ‘exceptional measures’ taken by the Argentine government were justified because of the existence of a state of necessity, an emergency situation which might preclude, in one way or the other,⁷⁶ state responsibility for an internationally wrongful act.

⁶⁸ Cited in Damon Vis-Dunbar, Luke Eric Peterson and Fernando Cabrera Diaz, *Investment Treaty News* May 9 2007.

⁶⁹ See White & Case: ‘Treaty Developments Related to Bolivia, Ecuador, and Venezuela’ *International Disputes Quarterly*, Fall 2007. Ecuador will also be reassessing each of its 23 existing BITs.

⁷⁰ ICSID News Release, “Ecuador Submits a Notice under Article 71 of the ICSID Convention” July 9 2009.

⁷¹ Kaushal, *supra* n. 26, 493.

⁷² *Ibid* 492. Similarly: José E. Alvarez and Kathryn Khamsi, “The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime” in K. P. Sauvant, (ed.), *Yearbook on International Investment Law & Policy, 2008-2009* (Oxford University Press 2009) 379-478, 385-386. One should probably view these incidents against the background of past and present economic, cultural, political and ideological issues as well.

⁷³ Kenneth Rogoff and Carmen Reinhart, *This Time It’s Different: 700 Years of Financial Folly* (Princeton University Press 2009) 10–12.

⁷⁴ ‘A decline without parallel—Argentina’s Collapse—Explaining Argentina’s Economic Collapse’, *The Economist*, (Special Report), March 2–8, 2002, 26.

⁷⁵ At the moment, 30 disputes between Argentina and foreign investors in which decisions have been issued by various are noted at the website Investment Treaty Arbitration.

http://ita.law.uvic.ca/alphabetical_list_respondant.htm Most of these bear directly out of financial crisis. 24 cases against Argentina are currently pending before ICSID tribunals.

<http://icsid.worldbank.org/ICSID/FrontServlet?requestType=GenCaseDtIsRH&actionVal=ListPending>

⁷⁶ Depending on the legal context in which it is invoked. In this case it was both under customary international law and a necessity clause in the investment treaty between Argentina and the U.S. See *infra*.

It is difficult to prove empirically, but I agree with Kaushal in that the outcome of these cases (many of which are still ongoing) contributed to a perceived lack of legitimacy of the regime, and that this was likely a key reason for these moves by States to exit it.⁷⁷ The cause of these events is not primarily an issue of insufficient compliance with either the ICSID Convention or the international investment treaties. Rather, it is the slightly different question of denunciation from such treaties.⁷⁸ A balancing approach by treaty tribunals might help mitigate this legitimacy deficit, but, as we shall see below, in their interpretative approaches tribunals should be careful to avoid stretching the underlying legal norms available to them.

Developed countries have had their own qualms with the regime. According to UNCTAD, at the end of 2008 the total number of BITs worldwide was 2,676,⁷⁹ a large majority of which has been signed after the 1990s. Regional investment treaties have followed suit, with the NAFTA and The European Energy Charter Treaty among the most renowned. An endeavor by The Organisation for Economic Co-operation and Development (OECD) to create the more comprehensive Multilateral Agreement on Investment (MAI) fell through in 1998, in part due to public protest and issues allegedly relating to national sovereignty and democracy.⁸⁰ Such negative public opinion—typically voiced by NGOs—has also faced BITs and the NAFTA. This has occurred in particular following awards where state regulations issued on the grounds of environmental concerns, labor rights and public health were found to be in breach of the treaty obligations of the state, but at the moment there seems to be a generally unfavorable opinion against investment treaties.⁸¹ Notably, claims issued by

⁷⁷ M.D. Nolan and F.G. Sourgens: 'The Interplay Between State Consent to ICSID Arbitration and Denunciation of the ICSID Convention: The (Possible) Venezuela Case Study' *Transnational Dispute Management* September 2007. The ICSID Convention has long been regarded in Latin America as 'an intrusion on host country sovereignty', cf. Andreas Lowenfeld, *International Economic Law* (Oxford University Press 2003) 460 and P. C. Szasz: 'The Investment Disputes Convention and Latin America' 13 *Virginia Journal of International Law* (1971) 256–265. Earlier arbitration awards have caused states to withdraw from international arbitration, most notably the Aramco case, which in 1963 caused Saudi Arabia to promulgate a decree that prohibited arbitration in disputes where the Government (or any of its subdivisions) was party. Jacques Werner: 'The Global Arbitrators' 8 *Journal of World Investment & Trade* (2007) 745–751.

⁷⁸ Denunciation from BITs is not as straightforward as is the case with ICSID See e.g. Bolivia–Germany BIT Article 14(3); Bolivia–UK BIT Article 13; and the Venezuela–Netherlands BIT Art. 14(2), which provides that the treaty is valid for 10–year periods at a time unless denounced at least six months before the expiry of the validity period. Consequently, even if a state has denounced from both ICSID and an its international investment treaties, such 'survival clauses' provide that investment disputes can still arise where the international investment treaty provides alternatives to ICSID arbitration, for instance the ICSID Additional Facility Rules (where it suffices that either the claimant's (the investor) home state or the respondent (the host state) is party to ICSID) or UNCITRAL, see e.g. Article 8 of the Bolivia–UK BIT, May 24, 1988, Article IX of the Bolivia–U.S. BIT of April 17, 1998 and U.S. Model BIT, Section B, Article 24 (3).

⁷⁹ UNCTAD, *World Investment Report 2009* (Geneva 2009) 32.

⁸⁰ Thomas Wälde and Abba Kolo: 'Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law' 50 *International and Comparative Law Quarterly* (2001) 811–847. An insider's account of both the proposal and the drafting process is provided by Rainer Geiger: 'Regulatory Expropriations in International Law: Lessons from the Multilateral Agreement on Investment' 11 *New York University Environmental Law Journal* (2002–2003) 95–109. Andrew Newcombe, 'The Boundaries of Regulatory Expropriation' 20(1) *ICSID Review–FILJ* (2005) 1, notes that public protest arose because of various so called indirect expropriations cases, most of which will be discussed infra.

⁸¹ See *supra* n. 10 and e.g. Public Citizen: 'NAFTA Chapter 11 investor–state cases: Bankrupting Democracy', September 2001, available at: <http://www.citizen.org/documents>; Public Citizen: 'NAFTA's Threat to Sovereignty and Democracy: The Record of NAFTA Chapter 11 Investor–State Cases 1994–2005', February 2005, available at <http://www.citizen.org/documents>; the documentary 'Trading Democracy', available at <http://www.pbs.org> (Transcript available at: http://www.pbs.org/now/transcript/transcript_tdfull.html); Anthony DePalma, 'Nafta's Powerful Little Secret; Obscure Tribunals Settle Disputes, but Go Too Far, Critics Say', *New York Times* 11 March 2001; Stuart G. Gross, 'Inordinate Chill: BITs, Non–NAFTA MITs and Host–State

Canadian investors against the United States under NAFTA resulted in much debate in the U.S. Congress concerning a possible threat to democracy and regulatory ability provided by the investment treaties the U.S. have signed.⁸² Furthermore, as Kaushal notes in a similar context, NGOs have ‘sought procedural access to NAFTA and BIT proceedings and permission to submit amicus curiae briefs.’⁸³ She argues additionally that revisions of the US Model BIT were made ‘to constrain the expansive interpretations of NAFTA tribunals, including the addition of noneconomic objectives such as ‘health, safety, environment, and the promotion of internationally recognized labor rights’ to the preamble.’⁸⁴ Most of these cases related to the distinction between a permissible regulation and indirect expropriations under either NAFTA or BITs. We shall see how tribunals also in this case finally turned to the principle of proportionality in order to counter such legitimacy related critique.

The next section, however, brings a closer examination of the application of the principle of proportionality as a defensive judicial strategy.⁸⁵

3. The legitimacy-enhancing function of the proportionality analysis in judicial review

It has been argued that ‘some version of a proportionality test’ is a general feature of rights adjudication worldwide.⁸⁶ At any rate, over the past fifty years or so proportionality analysis, as Stone Sweet and Matthews observe in a powerfully argued article, has become a widespread adjudicative technique for ‘managing disputes between rights involving an alleged conflict between two rights claims, or between a rights provision and a legitimate state or public interest.’⁸⁷ Following a detailed analysis of the principle in the constitutional law jurisprudence of various jurisdictions, EU law, European human rights law and WTO law, the authors contend that when adjudicators turn to employ proportionality analysis this might generate processes that serves to ‘enhance, radically, the judiciary’s role in both lawmaking and constitutional development’.⁸⁸

Regulatory Freedom — An Indonesian Case Study’ 24 *Michigan Journal of International Law* (2003) 893–960; ‘RE: Refusal to respect Bolivia’s withdrawal from investment dispute court’, letter to the President of the World Bank of 15 January 2008, written by representatives of 863 civil society organizations in 59 countries. (available at: <http://www.grupoapoyo.org/basn/node/27>). I assume that the extent of this ‘negative public opinion’ is fairly represented by this letter.

⁸² Van Harten *supra* n.26, 40.

⁸³ Kaushal, *supra* n. 26, 494.

⁸⁴ Ibid. She also points to Norway’s Draft Model BIT, which went in the same direction, but which has been shelved by the government. See Luke Eric Peterson, ‘Norway proposes significant reforms to its investment treaty practices’, *Investment Treaty News* 27. March 2008, who cites a commentary released with the Draft Model BIT, in which it is stated that the aim was ‘to lead the development from one-sided agreements that safeguard the interests of the investor to comprehensive agreements that safeguard the regulative needs of both developed and developing countries, making investors accountable while ensuring them predictability and protection.’ and Vis-Dunbar *supra*, n. 38. Indeed, this happened partly because some ‘felt the model would restrain governments’ ability to regulate in the public interest.’ Similarly on the Canadian Model BIT: L. Yves Fortier, ‘The Canadian Approach to Investment Protection: How Far We Have Come’ in Binder *et al* (eds.), *supra* n. 38, 525-543, 531.

⁸⁵ Stone Sweet and Matthews *supra* n. 15, 83.

⁸⁶ Mattias Kumm, ‘Political Liberalism and the Structure of Rights: On the Place and Limits of the Proportionality Requirement’ in George Pavlakos (ed.), *Law Rights and Discourse: Themes from the Legal Philosophy of Robert Alexy* 131, 131–132

⁸⁷ Stone Sweet Mathews, *supra* n. 15 73.

⁸⁸ Ibid, 160–161, cf. the discussion in n. 63 above.

One slightly different, but not, I think, differing way of looking at their analysis of the jurisprudence is to regard the usage of proportionality analysis less as a technique for legal activism than as the preferred modality with which modern courts in a European post-World War II context of novel constitutionalism (where these institutions did not have the powerful standing of e.g. the Supreme Court of the U.S.—whose long-standing practice as ‘activist’ dates back at least to the 1803 case of *Marbury v. Madison*⁸⁹ but in a context of which the political room for rights discourse and practice was considerable) have implemented their horizontally directed assertion of power.⁹⁰ The advantage (and perhaps success) of proportionality analysis in this respect lies in its ability for adjudicators to mask their scrutiny as an inquiry into process rather than as a review of policy,⁹¹ and to do so in precisely the types of decisions where the legal question is the ‘most in danger of being constructed in a partisan way.’⁹²

By ‘proportionality analysis’ I mean here a model for judicial analysis consisting of three different elements: suitability, necessity, and proportionality *stricto sensu*, which must be assessed cumulatively.⁹³ The first of these implies ‘whether the measure at issue is suitable or appropriate to achieve the objective it pursues.’⁹⁴ For a measure to be suitable the existence of ‘a causal relationship between the measure and its object’ is required.⁹⁵ For a measure to be necessary there must exist no alternative measure that is both less restrictive than the measure being reviewed and equally effective in achieving the objective pursued.⁹⁶ This stage of the analysis exists in a somewhat uneasy relationship with the notion of a wide margin of appreciation left to State parties by international adjudicators,⁹⁷ which sometimes seems to cause them to skip this stage altogether, as appears to have been the case in the award in the *Tecmed* case discussed below.⁹⁸ Under investment treaties, furthermore, there are usually

⁸⁹ *Marbury v. Madison*, 5 U.S. (1 Cranch) 137 (1803). One of the best descriptions of it as such, comes from the late constitutional historian Leonard W. Levy, *Original Intent and the Framers' Constitution* (MacMillan 1988) 75, describing it as ‘one of the most flagrant specimens of judicial activism, and from the standpoint of judicial craftsmanship, resulted in one of the worst opinions ever delivered by the Supreme Court. Hardly a latitude or longitude of Marshall’s *Marbury* opinion lacked an inexactitude or an ineptitude. As a matter of judicial politics, however, it ranks among the craftiest in our constitutional history, and as a symbol of judicial review it ranks as the most important.’

⁹⁰ See e.g. Alec Stone–Sweet, *Governing With Judges: Constitutional Politics in Europe* (Oxford University Press 2002) 32 *et seq.* For an updated and ambitious analysis see, Juliano Zaiden Benvindo, *On the Limits of Constitutional Adjudication: Deconstructing Balancing and Judicial Activism* (Springer 2010); and Vanberg, *supra* n.54, 9–12 See also Wojciech Sadurski, *Rights Before Courts: A Study of Constitutional Courts in Postcommunist States of Central and Eastern Europe* (Springer 2005), esp. Chapter 2.

⁹¹ But it has not been without critics. Jacobs, for example, provides food for thought for a hypothetical skeptic, noting that ‘the application of the principle of proportionality in its more rigorous forms might be criticized on the ground that it goes beyond the judicial function. ... It is not, the critic may say ... the function of the courts to decide whether a particular exercise of power is the most appropriate way of achieving a particular policy goal.’ Francis G. Jacobs, ‘Recent Developments in the Principle of Proportionality in European Community Law’, in Evelyn Ellis, (ed.) *The Principle of Proportionality in the Laws of Europe* (Hart Publishing 1999) 1–21, 20.

⁹² Alec Stone–Sweet, *The Judicial Construction of Europe* (Oxford University Press 2004) 11.

⁹³ Jan Jans, ‘Proportionality Revisited’, 27 *Legal Issues of Economic Integration* (2000): 239, 240–41.

⁹⁴ Peter Van den Bosche, ‘Looking for Proportionality in WTO Law’ 35 *Legal Issues of Economic Integration* (2008) 283–294, 285.

⁹⁵ Jans, *supra* n. 93, 240

⁹⁶ *Ibid*

⁹⁷ See *Mellacher and Others v. Austria* (19 December 1989, Series A no. 169) para. 53; *Hatton and Others v. United Kingdom* (2. October 20001, Appl. No. 36022/97) (Partly dissenting opinion of Judge Greve) p. 32;

⁹⁸ *Tecmed v. Mexico* This seems to me to be somewhat misguided in that case. In the other award examined in-depth here, this was not the case. However, the characterization of the relationship with proportionality and

several standards of protection, each of which can be applicable in a specific case. Some of these might make the requirement for no less restrictive alternatives more explicit, such as prohibitions against arbitrary and discriminatory measures. Proportionality analysis sometimes seems to encompass this, and more rule of law-related scrutiny, as well.⁹⁹

Finally, the measure must meet the requirement of proportionality *stricto sensu*, which ‘involves an assessment of whether the effects of a measure are disproportionate or excessive in relation to the interests involved.’¹⁰⁰ As Andenas and Zleptnig put it in a WTO context:

It is at this stage that a true weighing and balancing of competing objectives takes place. The more intense the restriction of a particular interest, the more important the justification for the countervailing objective needs to be.¹⁰¹

This final element comes into play after it has been established that measure in question has passed the suitability and necessity tests, and it is this *stricto sensu* phase that is used to scrutinize the government’s level of protection.¹⁰² Consequently, the application of this phase in the review can be regarded as the difference between hard and soft proportionality analysis.

1. The function of proportionality analysis in international judicial review

Proportionality analysis serves many purposes in judicial review.¹⁰³ Stone Sweet and Matthews argue that it has a dual role for judges:

1. to manage potentially explosive environments, given the politically sensitive nature of rights review.
2. to establish, and then reinforce, the salience of constitutional deliberation and adjudication within the greater political system.¹⁰⁴

Put differently, as Maduro observed in EU context, ‘[t]he underlying idea is that the State’s definition of policy is left intact while it remains possible to control measures that, though presented as ‘necessary’ for such policies, are in fact not so’.¹⁰⁵ Thus, proportionality analysis might function strategically ‘[a]s an instrument of market integration’ by limiting and requiring the justification of measures taken by the Member States within its scope of

discretion as ‘uneasy’ is still apt. I will not consider that aspect below, but for a similar analysis with respect to the WTO jurisprudence cited by the Tribunal, see Donald H. Reagan, ‘The meaning of ‘necessary’ in GATT Article XX and GATS Article XIV: the myth of cost-benefit balancing’ 6 *World Trade Review* (2007) 347-369, 352-353.

⁹⁹ *Hentrich v. France* (22. September 1994, Series A no. 296-A) para 45-46. For analysis, see Jonas Christoffersen, *Fair Balance: Proportionality, Subsidiarity and Primarity in the European Convention on Human Rights* (Martinus Nijhoff 2009) 129.

¹⁰⁰ Van den Bossche, *supra* n. 94, 285.

¹⁰¹ Mads Andenas and Stephan Zleptnig, “Proportionality: WTO Law: In Comparative Perspective” 42 *Texas International Law Journal* (2007), 371, 390

¹⁰² Van den Bossche *supra* n. 94, 285.

¹⁰³ For a thorough treatment, see Andenas and Zleptnig, *supra* n. 95, identifying at least six functions of the principle. Here I am concerned primarily with its function as a standard for judicial review and as ‘a tool to determine the scope and limitations of legal norms’. *Ibid.* 385–386.

¹⁰⁴ Stone Sweet and Matthews *supra* n.15 88–89

¹⁰⁵ Miguel Poirares Maduro, *We The Court: The European Court of Justice and the European Economic Constitution—A Critical Reading of Article 30 of the EC Treaty* (Hart 1998) 54–55.

applicability.¹⁰⁶ In investment treaty arbitration, a corresponding role is conceivable, but so far proportionality has primarily been evoked as a State defense¹⁰⁷ rather than as a standard that can serve as “an instrument of rationalization” of State measures affecting foreign investors.¹⁰⁸ This is perhaps less testimony to a more developed proportionality analysis jurisprudence in the Court of Justice the European Union than in investment treaty arbitration as such than to the differences with respect to the legal and political environment in which the institutions have, so far, been exercising their duties.

Similarly, in the jurisprudence the European Court of Human Rights (ECtHR), arguably a court with less political clout than the Court of Justice of the European Union,¹⁰⁹ proportionality analysis can be regarded as the corollary to its lenient standard of review known as the ‘margin of appreciation’ doctrine, which is crucial to the relation between proportionality analysis and legitimacy of international judicial review. In this sense, proportionality analysis might serve as a limit to ‘judicial self-restraint’.¹¹⁰

It is in this vein, though perhaps reversing cause and effect, Julian Barnes has claimed that ‘as proportionality has been increasingly accepted as a criterion of judicial review, judiciaries have been creating various discretionary devices to soften its apparent impact’, referring to ‘terms such as ‘margin of appreciation’, ‘margin of discretion’, ‘due deference’, ‘variable intensity of review’, ‘sliding scale of review’’,¹¹¹ even noting that ‘discretion is treated as an inevitable component of proportionality review’ and therefore ‘not a marginal phenomenon, but (...) potentially co-extensive with proportionality.’¹¹² Though this doctrine of discretion has been criticized,¹¹³ and because it by definition implies state-bias in litigation between States and individuals—arguably, it was developed as a tactical response to the system’s ‘fragile foundations’—¹¹⁴ proportionality analysis serves as the mitigating factor between the permissible and non-permissible outcomes of legitimate policies.¹¹⁵ As we shall see below,

¹⁰⁶ *Ibid*, 136. This function is of course related to review of national measures. Proportionality analysis has also been employed in the analysis of Community measures. See e.g. *ibid* and Jacobs *supra* n. 91; Tor-Inge Harbo, “The Function of the Principle of Proportionality in EU Law” 16 *European Law Journal* (2010) 158-185, who argues that the ECJ review of community measures is less strict than that of the member states.

¹⁰⁷ Eg. *BG Group Plc v. Argentina* para. 252.

¹⁰⁸ To borrow a more recent phrase from Maduro (though used in a slightly different context). Miguel Poiars Maduro, “Passion and Reason in European Integration”, *Vortrag an der Humboldt-Universität zu Berlin* February 10, 2010. Available at <http://ssrn.com/abstract=1709950>

¹⁰⁹ Nina Louisa Arold, *The Legal Culture of the European Court of Human Rights* (Martinus Nijhoff 2007) 162; James A. Sweeney, ‘A Margin of Appreciation in the Internal Market: Lessons from the European Court of Human Rights’ 34 *Legal Issues of Economic Integration* (2007) 27–52, 42.

¹¹⁰ Thomas Franck, ‘On Proportionality of Countermeasures in International Law’ 102 *American Journal of International Law* 715, 760–761 The phrase ‘judicial self-restraint stems from *Cossey v. The United Kingdom* (Application no. 10843/84) (Judgment) 27 September 1990, *Dissenting opinion of Judge Martens*. at 3.6.3 .

¹¹¹ Julian Barnes, ‘Proportionality and Discretion in international and European law’ in Nicholas Tsagourias (ed.), *Transnational Constitutionalism: European and International Models* (Cambridge University Press 2007) 107–131, 107

¹¹² *Ibid*, 108.

¹¹³ Eayl Benvenisti, “Margin of Appreciation, Consensus and Universal Standards” 31 *International Law and Politics* (1999) 843-854; Lord Lester QC, ‘Universality Versus Subsidiarity: A Reply’ (1998) *European Human Rights Law Review* 73

¹¹⁴ Eva Brems “The Margin of Appreciation Doctrine in the Case-Law of the European Convention of Human Rights” 56 *Zeitschrift für ausländisches öffentliches Recht und Völkerrecht* (1996), 240-314, 297–298.

¹¹⁵ Or, as one author put it, it “acts as a corrective and restrictive of the margin of appreciation’. F. Matscher “Methods of Interpretation of the Convention” in R. St. J. Macdonald, F. Matscher and H. Petzold, (eds.), *The European System of the Protection of Human Rights* (Martinus Nijhoff 1993) at 63-81,79. See also Yutaka Arai-Takahashi, *The margin of appreciation doctrine and the principle of proportionality in the*

investment treaty tribunals have, similarly, conducted proportionality analyses explicitly in connection with references to phrases similar to “margin of appreciation”.

In this sense proportionality analysis serves as the nexus between the ECtHR’s function both as a guarantor of individual rights and as a servant of its masters under international law, the States upon whose consent, compliance and commitment its existence is conditioned. In other words, the balancing test can be regarded as the most effective, yet non-intrusive and therefore least costly technique by which international, transnational and supranational adjudicative organs bodies might exercise some form of control over the affairs of sovereign States while taking into account the reciprocal nature of international agreements providing individuals with access to court.¹¹⁶ Thus, there are ‘powerful strategic reasons’ for adjudicators’ adoption ‘of balancing posture; and they use techniques associated with balancing to mitigate certain strategic dilemmas.’¹¹⁷

In their article, Stone Sweet and Matthews argue that the attractiveness of proportionality analysis in modern, complex societies lies in its ability to mitigate problems for adjudicators in what they call a ‘2-against-1 situation’. Such situations arise in any third-party dispute resolution context in which the adjudicators are dependent upon the parties’ perception of their neutrality *vis-à-vis* the parties. As international adjudicators are in many respects engaged in international lawmaking,¹¹⁸ their choice among conflicting values also includes ‘favoring one policy interest over another.’¹¹⁹ Balancing through proportionality analysis is then a preferable strategy to mitigate legitimacy attacks from either of the parties because it makes clear that:

- (a) that each party is pleading a constitutionally-legitimate norm or value;
- (b) that, *a priori*, the court holds each of these interests in equally high esteem;
- (c) that determining which value shall prevail in any given case is not a mechanical exercise, but is a difficult judicial task involving complex policy considerations; and
- (d) that future cases pitting the same two legal interests against one another may well be decided differently, depending on the facts.¹²⁰

Notably, these factors do not seem to require the full-fledged three-step test outlined above, but at least the first of them appears to presuppose a suitability analysis.

I. The function of proportionality analysis in investment treaty arbitration

European Convention on Human Rights (Kluwer 2001) 14; Wälde and Kolo, *supra* n.80, 830, referring to *The Trustees of the Late Duke of Westminster’s Estate v. UK* (1983) 5 EHRR 440 at 456. Note that the argument seems to be derived from the applicants’ claim, not, as the authors argue, from the ECtHR’s decision. Furthermore, the decision was an admissibility application before the European Commission of Human Rights.

¹¹⁶ See also Paul Craig, ‘Judicial Review, Intensity and Deference in EU Law’ in David Dyzenhaus, *The Unity of Public Law* (Hart 2004) 335–356.

¹¹⁷ Stone–Sweet, *supra* n. 20, 3.

¹¹⁸ Alan Boyle and Christine Chinkin, *The Making of International Law* (Oxford University Press 2007) 268 (“international courts do ... do play a major law-making role”; Rosalyn Higgins, *Problems and Process: International Law and How We Use It* (Clarendon Press 1995) 202 (“[The function of the ICJ] is not to develop international law in the abstract. But, of course, the very determination of specific disputes, and the provision of specific advice, *does* develop international law.”).

¹¹⁹ Stone–Sweet and Matthews *supra* n. 15, 85.

¹²⁰ Stone–Sweet and Matthews *supra* n. 15, 89.

In investment treaty arbitration, this 2-against-1 problem is exacerbated, because the interests of one of the state parties to the investment treaty in question, the home state of the foreign investor instigating arbitration both has an interest in the concrete case (the well-being of a company of which it is a home state and through which it, too, wields power in international relations) and in the systemic outcome of the case, i.e. that it's own right to take similar measures against foreign investors covered by the same treaty at home are not unduly limited. In my view, then, the function of the principle of proportionality in this context is best regarded as inducing legitimacy upon the political power *and* the decisions of institutions with little or no democratic legitimacy. This function can be explained by the fact that courts are limited by law and permissible legal reasoning. As Bodansky has argued,

‘[l]egal legitimacy is what connects an institution’s continuing authority to its original basis in state consent. The authority of the International Court of Justice, for example, derives from its Statute, to which UN member states consented. And the Court’s continuing authority depends on its acting in accordance with the Statute. If it went outside or against the Statute, then its actions would lack legitimacy.’¹²¹

It is within these constraints proportionality analysis maximize adjudicative bodies’ long-term powers in a subtle and non-intrusive manner by serving as the nexus between legal and social legitimacy. As such, it’s attractiveness is as easily understandable as its extraordinary diffusion. However, even if, as Stone Sweet and Mathews observe, proportionality analysis is ‘a doctrinal construction’ which ‘emerged and then diffused as an unwritten, general principle of law through judicial recognition and choice’,¹²² this does not mean that courts and tribunals should feel free to employ the principle in any and all factual and legal contexts,¹²³ without taking due regard to factors such as the structure of the underlying legal instruments, the wording of the relevant provisions, and the rules and principles with which they are empowered to adjudicate. This is because investor-state arbitration, like any dispute settlement, is fundamentally ‘a rule driven process’, meaning that, though it might seem like a trite observation, ‘[a]rbitrators have the duty to decide investor-state disputes according to the law.’¹²⁴

When arbitrators perform proportionality analysis on a legally unsound basis, they are undermining its legitimacy-influencing aspects. As Grosman has put it, rulings and judgments lose their authority not only if they do not ‘accord with interests and values’ but also if they are not ‘framed in the predominant legal discourse.’¹²⁵ In the following section, I argue that investment tribunals have not always been careful enough when performing proportionality analysis to earn the acclaim of the invisible college. Even though the following part brings a relatively detailed and critical analysis of two awards where the Tribunals conducted proportionality analyses, I do not in much detail scrutinize the specific usage of the

¹²¹ Daniel Bodansky ‘The Legitimacy of International Governance: A Coming Challenge for International Environmental Law’ 93 *American Journal of International Law* (1999) 596, at 605

¹²² Stone Sweet and Mathews, *supra* n. 15, 74. It is unclear whether this is intended to convey any doctrinal legal meaning in the sense of Article 38 (1) (c) of the Statute of the International Court of Justice. For this approach, see e.g. Franck, *supra* n. 100, 716. At any rate, Stone Sweet and Mathews emphasize, like I do here, proportionality analysis “as an argumentation and balancing framework”, or a “decision making procedure. Ibid, 75.

¹²³ As they no doubt acknowledge.

¹²⁴ Salacuse *supra* n. 26, 382.

¹²⁵ Grosman *supra* n. 27, 143.

proportionality principle in comparison with how other courts and tribunals have employed it. That inquiry will be dealt with elsewhere. Here, what I am concerned with is rather the legal foundations of the proportionality analyses that Tribunals have conducted.

4. The application of the proportionality principle in its 'new frontier'

I. Proportionality analysis and the distinction between regulation and indirect expropriation

As noted above, legitimacy concerns in investment treaty arbitration has in particular been related to expropriation claims. Indeed, the taking of alien property by a state without compensation was long a hotly debated issue in international affairs.¹²⁶ The 1960s saw the first rise of Bilateral Investment Treaties (BITs) by developed countries 'as a way to protect their investments abroad against the growing risks of expropriation and nationalization.'¹²⁷ However, in recent years these "risks have greatly abated".¹²⁸

Today, the legality of expropriations of foreign property under international law is not contested.¹²⁹ In order to decide whether an expropriation is lawful under customary international law, an expropriation must be undertaken for a public purpose, not be discriminatory, in accordance with due process and, as mentioned, accompanied by compensation.¹³⁰ Most investment treaties contain this standard, though the details may vary somewhat.¹³¹ The direct taking without compensation, on the other hand, has become unfashionable.¹³²

In contemporary international investment law, what remains contested, like in many domestic law systems, is the line between the permissible, non-compensable regulation (affecting the property of foreign investors) and so-called indirect expropriation, which does not require a formal transfer of title of the investment.¹³³ The latter requires compensation to the foreign investor, the former not. However, if no compensation has been provided, this does of course not in itself entail that no expropriation has taken place but only whether, if there—legally speaking—was an expropriation, it was illegal. If it was illegal, the investor is entitled to damages, the sum of which can be very different from compensation. Therefore, the key

¹²⁶ The literature is extensive, cf. for instance footnote 6 in the 9th edition of Oppenheim's. That footnote accompanies a sentence similar to the one this footnote accompanies and spans four pages. Sir Robert Jennings and Sir Arthur Watts (eds.), *Oppenheim's International Law* (Volume 1, parts 2 to 4) (Longman 9th ed. 1996) 912-915.

¹²⁷ Zampetti and Sauvé, *supra* n.43, 211–2, 225.

¹²⁸ Rudolf Dolzer and Christopher Schreuer, *Principles of International Investment Law* (Oxford University Press 2008) 91

¹²⁹ See e.g. Malcolm N. Shaw, *International Law* (Cambridge University Press 6th edition 2008) 828.

¹³⁰ Surya P. Subedi, *International Investment Law: Reconciling Policy and Principle* (Hart 2008) 74.

¹³¹ See e.g. UNCTAD, *Bilateral Investment Treaties 1995–2006* (2007) 52.

¹³² Dolzer and Schreuer, *supra* n. 128, 92.

¹³³ For an influential early inquiry into this problem in international law, see G. C. Christie 'What Constitutes a Taking under International Law' 33 *British Year Book of International Law* 307 (1962). The so-called indirect expropriation is known under many names, such "as regulatory, constructive, consequential, disguised, de facto or creeping." W. Michael Reisman & Robert D. Sloane, "Indirect Expropriation and Its Valuation in the BIT Generation," 74 *The British Year Book of International Law* 115 (2004) 115-150, 119.

question is whether an expropriation has taken place.¹³⁴ If so, some form of indemnification is necessary.

Arbitral tribunals have grappled with this distinction between the permissible regulation and the indirect discrimination in several prominent cases, and it is perhaps testimony to the difficulties of the legal analysis that the jurisprudence is relatively fragmented. Three main approaches can be identified,¹³⁵ however, in which different criteria have been given different weight by different tribunals. The first of these is investor centered, the second is state centered while the third is a combination of the two. It is in this sense, as shown above with respect to the 2-against-1 situation,¹³⁶ that proportionality analysis was introduced in investment treaty arbitration, in a manner which—at least analytically—sought to take the interests of both the investor and the state into account.

- 1) According to the ‘sole effects’ doctrine,¹³⁷ the only determinant to decide whether an indirect expropriation has taken place is the effect of the state measures upon the investment or investor. If the interference upon the investor’s property rights is sufficiently grave and ‘not merely ephemeral’,¹³⁸ an indirect expropriation has taken place.¹³⁹
- 2) Under the ‘radical police powers’ approach,¹⁴⁰ an arbitral tribunal seeks to establish whether a measure taken by government affecting a foreign investor or its investment serves a legitimate purpose. If this can be established, the measure will not be regarded as an expropriation. However, tribunals do exercise some scrutiny.¹⁴¹ This approach has been widely criticized in the literature.¹⁴²
- 3) The ‘moderate police powers’ approach,¹⁴³ on the other hand, combines the two elements above, relying chiefly on the effect of the government measures upon the investor or investment, while also taking the purposes of the measure into account. However, early awards employing this doctrine did not set out in any detail the relationship between the criteria.¹⁴⁴ It was not until the 2003 Award in the Case of *Tecmed v. Mexico* that a tribunal sought to explain this relationship. The analytical tool the tribunal used in that case was the principle of proportionality, hitherto

¹³⁴ Ursula Kriebaum, ‘Regulatory Takings: Balancing the Interests of the Investor and the State’ *The Journal of World Investment & Trade* (2007) 717–744, 720.

¹³⁵ I am relying here on the typology employed by Kriebaum, *supra* n. 134. A more nuanced version (more so than is necessary for our purposes) can be found e.g. in Dolzer and Schreuer, *supra* n. 128, 92–114 and Dugan *et al*, *supra* n.37, 450–490.

¹³⁶ See text accompanying footnote 105 above.

¹³⁷ The phrase was coined by Rudolf Dolzer, ‘Indirect Expropriations: New Developments?’ 11 *N.Y.U. Environmental Law Journal* (2002) 64, 79–80.

¹³⁸ See *Tippets, Abbett, McCarthy, et al v. TAMS-AFFA Consulting-Engineers of Iran*, Award No. 141–7–2 (29 June 1984), reprinted in 6 *Iran–U.S. Claims Tribunal Reports*, 219, 225.

¹³⁹ For examples of this approach, see *Metalclad Corporation v. United Mexican State* Case no. ARB(AF)/97/1, Award of 2 September 2000, para. 103. *PSEG v. Turkey*, paras. 278–279, *Enron* para. 245, *Parkerings Compagniet v. Lithuania*, para. 455; *Vivendi* para.7.5.20, *Sempra* para. 283

¹⁴⁰ Kriebaum, *supra* n. 134, 725–727 uses the same phrase.

¹⁴¹ *Methanex, Saluka*. See in particular the recent decision by very well respected arbitrators in *Chemtura Corporations v. Canada* (Award) (UNCITRAL), 2 August 2010, para. 266. In the latter case, the approach taken followed a discussion that was more similar to the “sole effects” doctrine. As such, the award seems to signal a desire to mitigate the two conflicting approaches.

¹⁴² See e.g. Markus Perkams, ‘Methanex — Erroneus on Expropriation?’ 2 *Transnational Dispute Management* (November 2005); See also *Vivendi II*, Award, 20 August 2007, explicitly rejecting this approach at para. 7.5.21.

¹⁴³ Kriebaum, *supra* n. 134, 727–729 uses the same phrase.

¹⁴⁴ *S.D. Myers; Feldman*. Kriebaum, *supra* n. 134, 727.

virtually unknown in investment treaty arbitration.

In that case, the claimant, a Spanish company, had acquired a hazardous industrial waste landfill in a Mexican public auction held in 1996 through its Mexican subsidiary, Cytrar. In 1994, Mexican environmental authorities (The National Ecology Institute, hereinafter referred to as 'INE') gave authorization for the landfill to operate for an indefinite period of time.¹⁴⁵ When the landfill was transferred to Cytrar, the company was authorized to operate the landfill until 19 November 1998, at which time such authorization could be extended every year at the applicant's request.

On 25 November 1998, however, INE rejected the application for renewal of the authorization, prompting Tecmed to seek damages in an investment tribunal under the BIT between Spain and Mexico. The Tribunal concluded that the primary motivation for the rejection of the authorization was 'related to social or political circumstances'.¹⁴⁶ It rejected Mexico's grounds for the refusal as either baseless or that the issue had been remedied. Importantly, the Tribunal also found that there was no evidence that the site posed any danger to human health or the environment.

The main question with regard to the rejection of renewed authorization was whether, due to this rejection, the assets involved lost their value or economic use for Tecmed as well as the extent of the loss.¹⁴⁷ In the Tribunal's opinion, this distinction was important to distinguish between a regulatory measure, whereby the State exercised its legitimate police powers, and a *de facto* expropriation that deprived the assets and rights involved of any real substance.¹⁴⁸ The Tribunal found 'undoubtedly' that the rejection had negative effects on Tecmed's investment and '[a]s far as the effects of such [rejection] is concerned, the decision [could] be treated as an expropriation under [the applicable BIT between Spain and Mexico]'.¹⁴⁹

As indicated, however, the Tribunal considered it necessary to evaluate not only the effect but also the intent or characteristics of the rejection.¹⁵⁰ The proportionality test, as mentioned above, was employed as a neat methodological approach in order to help making the distinction mentioned earlier between a compensable indirect expropriation and a non-compensable regulation. As the Tribunal put it:

'whether such actions or measures [were] *proportional to the public interest* presumably protected thereby *and to the protection legally granted to investments*, taking into account the significance of such impact has a key role upon deciding the proportionality.'¹⁵¹

¹⁴⁵ Para 36

¹⁴⁶ Para 132

¹⁴⁷ Para 115, referring to the Partial Award in the case of *Pope Talbot Inc. v. Government of Canada*, 102–104, pp 36–38.

¹⁴⁸ *Ibid.*

¹⁴⁹ Para. 117.

¹⁵⁰ Para. 118.

¹⁵¹ Para. 122.

The word 'proportionality' was accompanied by a footnote providing a reference, rarely seen in investment treaty arbitration,¹⁵² to the jurisprudence of the ECtHR,¹⁵³ though without any explanation about what kind of exercise the Tribunal was performing when doing so. Here, it could have explained whether it was conducting regular interpretation (as well as attempting some form of 'systemic integration' through VCLT Art. 31 (3) (c))¹⁵⁴ or application of some kind of general legal principle. This was probably among the reasons why one observer regards its application in this context as a challenge to host state sovereignty.¹⁵⁵

Furthermore, related to our discussion of discretion and proportionality above, the tribunal acknowledged that a due deference must be shown to the state 'when defining the issues that affect its public policy or the interests of society as a whole, as well as the actions that will be implemented to protect such values.'¹⁵⁶ However, the Tribunal did not allow this margin of discretion to prevent it from examining whether the measures taken by Mexico 'were reasonable with respect to their goals, the deprivation of economic rights and the legitimate expectations of [those] who suffered such deprivation.'¹⁵⁷ In order to determine whether such measures were reasonable, the Tribunal stated that '[t]here must be a reasonable relationship of proportionality between the charge of the weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure.'¹⁵⁸ Thus, when conducting the proportionality analysis, the Tribunal seems to have skipped the suitability and necessity stages of the three stages outlined above, if not lumping it all together,¹⁵⁹ in order to undertake the *strictu sensu* analysis directly.

At this stage, it went on to argue that it was important to measure both the size of the ownership deprivation 'and whether such deprivation was compensated or not', with a reference to an article by Yoram Dinstein.¹⁶⁰ In that paper he wrote that '...on the whole ... notwithstanding compliance with the public interest requirement, the failure to pay

¹⁵² Ole Christian Fauchald, "The Legal Reasoning of ICSID Tribunals – An Empirical Analysis" 19 *European Journal of International Law* (2008) 301-364, 342, noting that five tribunals have referred to the jurisprudence of the ECtHR and two to the Inter-American Court of Human Rights.

¹⁵³ *Matos e Silva, Lda., and Others v. Portugal*, Judgment of September 16, 1996, 85.

¹⁵⁴ Campbell McLachlan, 'The Principle of Systemic Integration and Article 31(3)(c) of the Vienna Convention' 54 *International & Comparative Law Quarterly* 279–320. Obviously, Mexico is not party to the ECHR, but it could have been possible to argue that the principle of proportionality constitutes customary international law or a general principle of law, see Franck *supra* n. 100 716. On systemic integration in this context, see Anne van Aaken, "Fragmentation of International Law: The Case of International Investment Protection" *University of St. Gallen Law School: Law and Economics Research Paper Series* (Working Paper No. 2008-1).

¹⁵⁵ Xiuli, *supra* n. 20, at 635.

¹⁵⁶ Para. 122. This connection, though not its explanation, is also provided by in a recent work by Newcombe and Paradell. Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties* (Wolters Kluwer 2009) 365.

¹⁵⁷ *Ibid.* But see the text accompanying n. 97 and 98 *supra*.

¹⁵⁸ *Ibid.* This time referring to *Mellacher and Others v. Austria*, judgment of 19 December 1989, 48, p. 24 and *Pressos Compañia Naviera and Others v. Belgium*, judgment of 20 November 1995, 38, p. 19.

¹⁵⁹ It could be argued that the suitability test is not necessary when the question is whether an indirect expropriation has taken place in the absence of compensation. As noted above, public purpose and non-discrimination are, together with compensation, some of the requirements for a lawful expropriation. For adjudicators, the issue of compensation is, factually, much easier to resolve than whether these requirements were fulfilled.

¹⁶⁰ *Ibid.*

compensation would render the deprivation of property inconsistent with the condition of proportionality.¹⁶¹

In itself this argument might have some merit. If one agrees that the duty to compensate follows from the principle of proportionality, and whereas, as mentioned above, compensation is a criterion for the lawful expropriation this might be analytically superior to the more radical approaches outlined earlier. But reframing the issue of the distinction between the illegal expropriation and the non-compensable regulation as one of proportionality, does not dissolve the question of whether one or the other has taken place.

In conclusion, the *Tecmed* Tribunal in this way used the proportionality test in order to determine whether an expropriation had occurred, whereas in the ECtHR jurisprudence it refers to it is used to decide whether expropriations that have occurred are justified.¹⁶² The main difference lies in the structure of the different legal provisions: the expropriation clauses in applicable investment treaties and the property protection clause of the ECHR¹⁶³ respectively. As noted above, it is more fruitful to employ proportionality analysis when the structure of a legal instrument allows for limitation of a right, rather than the all-or-nothing approach taken to distinguish between the illegal expropriation and the permissible non-compensable regulation. Here, a 2-against-1 situation seems to be the only outcome even after proportionality analysis because there are only two possible results: either the investor wins and it will have to be compensated for an illegal act under international law,¹⁶⁴ or the State wins and owes the investor no compensation. Some recent Model BITs have, seemingly, tried to accommodate this, for instance by, literally, copying the text of the ECHR property protection clause into BITs.¹⁶⁵

Later tribunals, under similar BITs, have found this usage of the proportionality principle helpful in order to make the distinction between the indirect expropriation and the non-compensable regulation.¹⁶⁶ However, many tribunals have recently preferred to replace the finding of an indirect expropriation with establishing a violation of the fair and equitable treatment provisions often found in BITs, a standard which, in itself, is more flexible than the

¹⁶¹ It should be noted that in the pages referred to in *Tecmed*, Dinstein was merely referring to the expropriation jurisprudence of the ECtHR. Incidentally, he did so through a secondary source, P. van Dijk and G.J.H. van Hoof, *Theory and Practice of the European Convention on Human Rights* (Kluwer Law 3rd ed 1998) 634, which, again, includes a discussion of the same cases the Tribunal in *Tecmed* pointed to in the first case.

¹⁶² Kriebaum, *supra* n. 134, 728.

¹⁶³ Protocol 1, Article 1. It reads:

Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

¹⁶⁴ See *Factory at Chorzow* (Germ. v. Pol.), 1927 P.C.I.J. (ser. A) No. 9 (July 26).

¹⁶⁵ The text of article 6(2) of the Norway Draft BIT is identical to the second paragraph of Article 1, Protocol 1, cf. *supra* n. 166. For an interesting analysis de lege ferenda on the usage of the proportionality principle in investment treaty arbitration based on the ECtHR approach, see, see Kriebaum, *supra* n. 134, 729 *et seq.*

¹⁶⁶ See *Asurix Corp. v. Argentine Republic*, ICSID (Award) July 14 2006, para. 311; *LG&E Energy Corp. v. Argentine Republic*, ICSID (Decision on Liability) October 3 2006. The *LG&E* panel, while referring to *Tecmed*, phrased the test in a narrow manner, stating that a legitimate, non-discriminate governmental measure “must be accepted without any imposition of liability, except in cases where the State’s action is obviously disproportionate to the need being addressed.” *Ibid*, para. 195. Most recently, the same approach was followed in *Total v. Argentina*, *supra* n. 17, para. 197. The award is discussed briefly toward the end of this paper.

rules of expropriation.¹⁶⁷ This path can therefore accommodate some of the same needs as proportionality analyses of expropriation claims. Some form of proportionality analysis might be applicable in this analysis too, however.

In the conclusion, I will present briefly how the Tribunal, in a very recent award in *Total v. Argentina* chose exactly this path, and I will argue that this approach includes hitherto the best use of proportionality analysis in investment treaty arbitration.

II. Proportionality analysis and the meaning of ‘necessity’ in investment treaties.

The second field in which arbitral tribunals have employed proportionality analysis was, seemingly, no more founded in the text of the applicable treaty and in an area-issue that had become no less controversial. These decisions involved the necessity defense of Argentina under Article XI of the U.S.–Argentina BIT,¹⁶⁸ and customary international law.¹⁶⁹ All of these awards entailed scrutiny of measures taken by Argentina during the 2000-2001 financial crisis mentioned above and most have been controversial in one way or the other. The usage of proportionality analysis by the Tribunal in one of them, *Continental Casualty*, as we shall see, was no less so.

Art XI of the US–Argentina BIT reads: ‘This treaty shall not preclude the application by either Party of measures necessary for the maintenance or restoration of international peace or security, or the protection of its own essential security interests.’ Interestingly, with respect to Argentina’s defense under this Article and under the customary international law standard of necessity, tribunals, evaluating essentially the same facts under the same legal norms concluded very differently and expressed differing views on the interpretation of art XI and the relationship between the two rules.¹⁷⁰

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¹⁶⁷ Ivar Alvik, *Contracting with Sovereignty: State Contracts and International Arbitration* (Hart Publishing 2011) 193.

¹⁶⁸ Treaty Between United States of America and Argentina Concerning the Reciprocal Encouragement and Protection of Investment, 14 November 1991, 31 *I.L.M.*, 124.

¹⁶⁹ *CMS Transmission Co. v. Argentine Republic*, ICSID (Award) May 12 2005; *LG&E Energy Corp. v. Argentine Republic*, ICSID (Decision on Liability) October 3 2006; *Enron Corp., Ponderosa Assets, L.P. v. Argentine Republic*, ICSID (Award) May 22 2007; *CMS Gas Transmission Company v. Argentine Republic*, ICSID (Annulment Proceeding) (Decision of the *Ad Hoc* Committee on the Application for Annulment of the Argentine Republic) September 25 2007; *Sempra Energy International v. Argentine Republic*, ICSID, (Award) September 28 2007; and *Continental Casualty v. Argentine Republic*, ICSID (Award), September 5 2008.

¹⁷⁰ Dugan *et al*, *supra* n.37, 158..

concluded very differently and expressed differing views on the interpretation of art XI and the relationship between the two rules.¹⁷¹

Even though Argentina, as Kurtz puts it, placed ‘enormous emphasis on the marginal claim’ that the treaty exception was self-judging,¹⁷² this was accepted by none of the tribunals nor of subsequent annulment committees.¹⁷³

In *CMS*,¹⁷⁴ *Sempra*¹⁷⁵ and *Enron*,¹⁷⁶ though with ‘subtle differences’,¹⁷⁷ the tribunals held that Art XI should be discussed in light of the customary international law standard of necessity,¹⁷⁸ whereas the Tribunals in *LG & E*,¹⁷⁹ *Continental Casualty*,¹⁸⁰ and both the *CMS* Annulment Committee¹⁸¹ and the recent *Sempra* Annulment Committee¹⁸² appears to have treated Art XI as a separate treaty defense (though not always in an identical manner).¹⁸³ In a notable

¹⁷¹ Dugan *et al*, *supra* n.37, 158..

¹⁷² Jürgen Kurtz, ‘Adjudging the Exceptional at International Investment Law: Security, Public Order and Financial Crisis’ 59 *International and Comparative Law Quarterly* (2010) 325–371,348.

¹⁷³ See *CMS* para. 373; *Enron*, para 339; *Sempra* para. 388; *LG & E* para. 212; *Continental Casualty* para. 174; *CMS Annulment* para. 122; *Sempra Energy International v. Argentine Republic*, ICSID, (Annulment Proceeding) (Decision of the *Ad Hoc* Committee on the Argentine Republic’s Application for Annulment of the Award) 29 June 2010 para. 170. Similarly, James Crawford, *The International Law Commission’s Articles on State Responsibility: Introduction, Text, and Commentaries* (Cambridge University Press 2002) 184.

¹⁷⁴ Para. 357 *et seq.*

¹⁷⁵ Para. 378. But see *Sempra* (Annulment Proceeding), in which the *Ad hoc* Committee annulled the award on the grounds that the Tribunal’s failure to consider Art. XI of the treaty as distinct from the similar CIL requirement constituted a manifest excess of powers in the meaning of Article 52 (1)(b) of the ICSID Convention.

¹⁷⁶ Para. 333.

¹⁷⁷ Kurtz, *supra* n. 172, 341.

¹⁷⁸ As reflected in Art. 25 of the ILC Articles on State Responsibility. Again, however, apparently without much reliance on the VCLT.

¹⁷⁹ See *Ibid*, para. 229, 245 and para. 258 where the Tribunal notes that Article 25 of the [Draft] Articles on State responsibility ‘supports’ its interpretation of Art. XI of the US–Argentine BIT. Kurtz (among others) have criticized this ruling, stating that the Tribunal may simply have excluded ‘the customary standard in its entirety.’ Kurtz, *supra* n. 172, 356.

¹⁸⁰ Para. 192

¹⁸¹ Para. 129. As Desierto has argued the *Ad hoc* Committee’s interpretation represented ‘a significant departure from the interpretive trends in *Sempra*, *LG&E*, and the Tribunal’s Award in *CMS*.’ Diane A. Desierto, ‘Necessity and ‘Supplement Means of Interpretation’ for Non–Precluded Measures in Bilateral Investment Treaties’ 31 *University of Pennsylvania Journal of International Law* (2009–2010) 827, 861

¹⁸² *Supra* n.173. In the view of the Committee, this position by the original Tribunal constituted a manifest “excess of powers within the meaning of the ICSID Convention.” (paras. 209, 218).

¹⁸³ Similarly, *BG Group Plc v. Argentina supra* n. 16, para 385 and 408 *et seq.* That case was decided under the UK-Argentina BIT, which did not contain a clause similar to Art. XI of the US-Argentine BIT. Scholars have shed considerable ink on this topic, but, while interesting, it is not necessary for the argument I make here. See e.g. Jose E. Alvarez and Tegan Brink ‘Revisiting the Necessity Defense: *Continental Casualty v. Argentina*’ (available at <http://www.iilj.org/publications/2010-3.Alvarez-Brink.asp>); Kurtz, *supra* n. 172; Desierto, *supra* n. 181, 893 *et seq.*; Christina Binder, ‘Changed Circumstances in Investment Law: Interfaces Between the Law of Treaties and the Law of State Responsibility With a Special Focus on the Argentine Crisis’ in Binder *et al* (eds.), *supra* n.44; Campbell McLachlan, ‘Investment Treaties and General International Law’ 57 *International & Comparative Law Quarterly* (2008) 361–401(extraordinarily, this article led to a challenge by an investor to McLachlan’s appointment as an arbitrator. See *Urbaser S.A. and Consorvio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. The Argentine Republic* (ICSID) (Decision on Claimant’s Proposal to Disqualify Professor Campbell McLachlan, Arbitrator, August 12 2010); William W Burke–White, ‘The Argentine Financial Crisis: State Liability under BITs and the Legitimacy of the ICSID System (2008) 3 *Asian Journal of International Health Law and Policy* 199; William W Burke–White and Andreas Von Staden, ‘Investment Protection in Extraordinary Times: The Interpretation and Application of Non–Precluded Measures Provisions in

decision that is bound to be undergo much scrutiny by legal scholars, the *Sempra* Annulment Committee annulled the original award on these grounds.¹⁸⁴ Here, however, the focus lies elsewhere.

Continental was a U.S. subsidiary of a leading provider of financial services, CNA Financial Inc. (CNA), headquartered in Chicago. Continental owned and controlled the Argentina-incorporated workers' compensation insurance provider, CNA Art.¹⁸⁵ This company, like other insurance companies, maintained an investment securities portfolio, which mainly consisted of various low-risk assets, including 'cash-deposit, treasury bills and government bonds.'¹⁸⁶

Due to the measures referred to as 'Argentina's Capital Control Regime'¹⁸⁷ enacted by the government in order to counter the economic crisis, Continental claimed that it had suffered an absolute loss in value of its assets exceeding \$ 46.4 million.¹⁸⁸ These measures involved a temporary block of deposits, a prohibition on the transferring of funds abroad as well as of free currency exchange, a termination of the peso convertibility and pegging to the US dollar at a 1:1 exchange rate,¹⁸⁹ rescheduling of term deposits maturity dates and interest rates, and a forced conversion of outstanding dollar-denominated contracts and both public and private debt at a rate of 1.4:1("pesification").¹⁹⁰

On the question whether these measures 'were necessary in order to maintain public order and protect essential security interests of Argentina', the Tribunal departed from the other awards in a somewhat controversial manner.¹⁹¹ It is this departure that demarks our point of interest here, as it included an in this context novel application of proportionality analysis, again with reference to extra-regime jurisprudence.

We should take note that the analysis was more sophisticated than in *Tecmed*. This was presumably due to the fact that the underlying legal norm analyzed in *Continental Casualty*, Art. XI of the U.S.–Argentina BIT, followed 'the normative structure of 'qualified rights'',¹⁹² unlike the expropriation clause in the Mexico-Spain BIT applied in the *Tecmed* award. Art. XI was therefore more suitable for proportionality analysis.

Bilateral Investment Treaties' (2008) 48 *Virginia Journal of International Law* (YEAR) 307; Surya P. Subedi, *International Investment Law: Reconciling Policy and Principle* (Hart 2008) 189–191; Michael Waibel, 'Two Worlds of Necessity in ICSID Arbitration: CMS and LG&E' 20 *Leiden Journal of International Law* (2007) 637; Stephen W. Schill, 'International Investment Law and Host State's Power to Handle Economic Crises — Comment on the ICSID decision in LG&E v. Argentina' 24 *Journal of International Arbitration* (2007) 265; and David Foster, 'Necessity knows no Law! — LG&E v. Argentina' 9 *International Arbitration Law Review* (2006) 149.

¹⁸⁴ *Supra* n.173, para. 222.

¹⁸⁵ Para 16.

¹⁸⁶ Para. 17.

¹⁸⁷ Para. 19.

¹⁸⁸ L.c.

¹⁸⁹ According to economist Martin Feldstein the fixed exchange rate, which of course was overvalued but which might have helped avoid hyperinflation, was one of two proximate causes to the financial crisis itself, the other being high amounts of foreign debt. Martin Feldstein, "Argentina's Fall: Lessons from the Latest Financial Crisis" 81 *Foreign Affairs* (2002: 2) 8-14, 8.

¹⁹⁰ Para 139.

¹⁹¹ Desierto notes that "Continental contains the most controversial interpretive methodology to date on Article XI of the U.S.–Argentina BIT.". Desierto, *supra* n. 181, 861.

¹⁹² Alec Stone Sweet, 'Investor–State Arbitration: Proportionality's New Frontier' 25.

Again, as in *Tecmed*, the application of proportionality analysis was accompanied with a reference by the Tribunal to the margin of appreciation:

‘[T]his objective assessment must contain a significant margin of appreciation for the State applying the particular measure: a time of grave crisis is not the time for nice judgments, particularly when examined by others with the disadvantage of hindsight.’¹⁹³

As mentioned above, this was followed by a discussion of whether Art. XI was self-judging, which the Tribunal (correctly) denied. A finding to the contrary at this point might well have rendered the adjudicative elements of the BIT virtually meaningless.

Acting outside the secluded area of State discretion, the Tribunal had to determine the content of the ‘concept’ of necessity in Art XI of the BIT. As I explained above, proportionality analysis can be said to consist of three elements, one of which is a necessity test. The key element in that respect is whether any alternative measure that was as effective and less restrictive was available.¹⁹⁴ This was where the Tribunal saw it fit to incorporate WTO case law in its analysis.

In order to decide whether the Argentine measures challenged by Continental were ‘necessary’ within the meaning of the BIT,¹⁹⁵ it argued that since:

‘the text of Art XI derives from the parallel model clause of the U.S. [Friendship Commerce and Navigation] treaties and these treaties in turn reflect the formulation of Art. XX of GATT 1947 (...)’¹⁹⁶ the Tribunal finds it more appropriate to refer to the GATT and WTO case law which has extensively dealt with the concept and requirements of necessity in the context of economic measures derogating to the obligations contained in GATT, rather than to refer to the requirement of necessity under customary international law.’¹⁹⁷

The fact that its suggestion that Art XI essentially is derived from GATT art. XX has been powerfully criticized notwithstanding,¹⁹⁸ by taking this path, it did not seem to regard itself engaged in interpretative activity within the confines of Article 31–32 of the VCLT.¹⁹⁹ Rather

¹⁹³ Para 181.

¹⁹⁴ See text accompanying n. 95 *supra*.

¹⁹⁵ And, again, differing from the Tribunals in *Enron* [para. 334] etc.

¹⁹⁶ Which reads: ‘...nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures: a) necessary to protect public morals; (b) necessary to protect human, animal or plant life or health; (d) necessary to secure compliance with laws or regulations...’

¹⁹⁷ Para. 192. This argument followed the Tribunal’s analysis on the relationship between Art. XI and the customary international law standard of necessity, in which it argued that the threshold of applicability of Art. XI was lower than that of necessity in customary international law, rather than first interpreting Art. XI and then concluding. See Para. 180.

¹⁹⁸ See Alvarez and Brink, *supra* n. 183, 23–30. Most importantly, Art XI of the BIT is much more similar to GATT Art. XXI (Security Exceptions). That GATT clause is, unlike Art XI of the BIT, self-judging. See e.g. Robyn Briese and Stefan Schill, “‘If the state considers’ Self-Judging Clauses in International Dispute Settlement” 1-58, Paper presented at the 16th annual ANZSIL Conference (26-28 June 2008), 1-58, 33.

¹⁹⁹ In this respect, see also the very careful analysis by Desierto, *supra* n. 181, 832, noting that ‘the Tribunal [in *Continental*] as treaty applier broadened its reach of interpretive sources in a manner seemingly inconsistent with the clear delimitations prescribed in Articles 31 and 32 of the VCLT.’ It is possible to argue that Art. 31(3)(c) of the VCLT, representing so-called ‘systemic interpretation’, could have allowed for the incorporation of GATT–jurisprudence into the interpretation of the BIT, but if that is what the Tribunal intended, they did not explain it. See McLachlan, *supra* n. 156, See also van Aaken, *supra* n. 156, 2, noting that ‘[i]nvestment tribunals may

than viewing the text of Art. XI contextually ‘from its limited understanding within the framework of the international obligations subsisting between the state parties to the BIT’,²⁰⁰ it interpreted it in the very different text,²⁰¹ structure context, object and purpose of Article XX of GATT,²⁰² a much broader exception clause.²⁰³ With regard to *that* necessity test, it noted, ‘it is well established that:

[...] the reach of the word ‘necessary’ is not limited to that which is ‘indispensable’ or ‘of absolute necessity’ or ‘inevitable.’ Measures which are indispensable or of absolute necessity or inevitable to secure compliance certainly fulfill the requirements of Article XX (d). But other measures, too, may fall within the ambit of this exception. As used in Article XX (d), the term ‘necessary’ refers in our view to a range of degrees of necessity. At a one end of this continuum lies ‘necessary’ understood as ‘indispensable;’ at the other, is ‘necessary’ taken to mean as ‘making a contribution to.’ We consider that a ‘necessary’ measure is, in this continuum, located significantly closer to the pole of ‘indispensable’ than to the opposite pole of simply ‘making a contribution to.’²⁰⁴

Notably, this approach to the necessity test the Tribunal can be regarded as ‘distinctly regulatory-friendly’ even in the context of GATT Art. XX.²⁰⁵

At any rate, even though the Tribunal cited jurisprudence in which the necessity requirement was located relatively close to ‘indispensable’, this determination was still based on a decidedly less restrictive necessity clause in which the aims to be achieved (e.g. protection of human health) are much more open than in Art XI. Thus, it formulated the WTO test: ‘a

therefore examine non–investment international law when interpreting investment law’ but (at 16) ‘the correct means of integration of non–investment law works through the applicability of Art. 31(3)(c) of the VCLT.’

²⁰⁰ Desierto, *supra* n. 181, 833. See also *ibid* 877–879, observing that there were many Articles in the BIT that explicitly made parts of it inoperable whereas Art XI is silent in this respect and arguing that ‘[t]he failure to provide for a clause stipulating the effect of a party’s application of measures under Article XI raises a justifiable implication that neither of the parties to the U.S.–Argentina BIT envisaged a situation where the treaty would be completely inappropriate, so as to prevent any of its substantive protections from taking effect. Had the parties to the U.S.–Argentina BIT intended otherwise, the text of Article XI should have been explicitly worded to provide for the effect of treaty inapplicability.’ Compare Art III of the BIT, where it is stipulated that the word ‘preclude’ does not imply non–applicability of the substantive rights afforded investors in the Treaty. (‘This Treaty shall not preclude either Party from prescribing laws and regulations in connection with the admission of investments made in its territory by nationals or companies of the other Party or with the conduct of associated activities, provided, however, *that such laws and regulations shall not impair the substance of any of the rights set forth in the Treaty.*’, italics are mine). However, the absence of a similar wording in Art. XI could be said to weaken the persuasiveness of this argument. Contra: Desierto, *supra* n. 181, 881.

²⁰¹ Desierto, *supra* n. 181, 884.

²⁰² Compare *Sempra*, para. 373 (given the object and purpose of the BIT, a restrictive interpretation is mandatory). Cf. *Sempra annulment committee* para. 191 *et seq.*

²⁰³ Similarly, Alvarez and Brink argue that ‘BITS, at least those following the U.S. model used for the U.S.–Argentina BIT, reach much deeper into the state parties’ regulatory pockets’ than GATT does. Alvarez and Brink *supra* n. 183, 33. See also Desierto, *supra* n. 181, 875.

²⁰⁴ Para 193, citing WTO Appellate Body, *Korea–Beef*, para 161. Conspicuously, however, the Tribunal omitted the first part of the Appellate Body’s interpretation of the word ‘necessary’, which read ‘as used in the context of Article XX(d)’ and did not attempt to argue that the context of GATT Article XX(d) was essentially similar to Article XI of the BIT.

²⁰⁵ Reagan, *supra* n. 98, 355.

measure is not necessary if another treaty consistent, or less inconsistent alternative measure, which the member State concerned could reasonably be expected to employ is available'.²⁰⁶

As others have observed,²⁰⁷ it did not seem to include the consideration of the GATT Art. XX introductory clause, which the WTO adjudicative bodies use as a second step under which measures that are found to be 'necessary' are appraised,²⁰⁸ thereby skipping the 'good faith'-review included in the WTO-version of the proportionality test.²⁰⁹

After setting out these standards, the Tribunal went on applying them to the facts in the case. In doing so, the central question for the Tribunal was whether the Measures taken by the Argentine Government 'were apt to and did make such a material or a decisive contribution to' protect its essential security interests in the economic and social crisis it was facing.²¹⁰

While not questioning the regulatory goal of Argentina's measures,²¹¹ the Tribunal held that the Measures were within the scope of this requirement under Art XI, as they were 'in part inevitable, or unavoidable, in part indispensable and in any case material or decisive in order to react positively to the crisis,' to prevent what it saw as (contrasting it again with other tribunals) 'the complete break-down of the financial system, the implosion of the economy and the growing threat to the fabric of Argentinean society and generally to assist in overcoming the crisis.'²¹² Interestingly, it seems to have described the objective in this way while making little attempt to connect it to the permissible objectives in the wording of Article XI.²¹³ This gave it the opportunity to conclude that there undoubtedly was 'a genuine relationship of ends and means between the objective pursued and the measure at issue'.²¹⁴ But in that very same paragraph in *Brazil-Tyres* the Appellate Body noted that in order to make this determination it is necessary to 'analyze the contribution of the measure at issue to the realization of the ends pursued by it *in accordance with the requirements of Article XX of the GATT 1994*'.²¹⁵ In other words, the necessity test should have analyzed the measures as a causal factor to achieve the strict objectives found in Art XI, not only against whether they were inevitable to counter the crisis.

Even so, while those measures that were regarded as inevitable, unavoidable or indispensable might be said to fall under a more narrow necessity test as well, those that were only 'material or decisive to react positively' would perhaps not. At any rate, it should be noted that the criterion that a measure must be "apt to make a material contribution to the achievement of its

²⁰⁶ Para. 195, referring to WTO Appellate Body, *US-Gambling*, 308.

²⁰⁷ Desierto, *supra* n. 181, at 882-891, Alvarez and Brink at 13-14, 30-32.

²⁰⁸ Benn McGrady, 'Necessity Exceptions in WTO Law: Retreaded Tyres, Regulatory Purpose And Cumulative Measures' 12 *Journal of International Economic Law* (2009) 153-173, 155.

²⁰⁹ Andrew D. Mitchell, *Legal Principles in WTO Disputes* (Cambridge University Press 2008) 191-192, compare 140.

²¹⁰ Para. 196, referring to WTO Appellate Body, [Brazil] *EC-Tyres*, 150.

²¹¹ Para. 199. I do not submit that there was reason to doubt the sincerity of Argentina's government in taking these measures, nor do I suggest that there was any hidden agenda undetected by the Tribunal. However, future Tribunals deciding on different facts should not regard the regulatory goal, even under a necessity clause, as beyond their scope of inquiry. See WTO Appellate Body, *US-Gambling* para. 304.

²¹² Para. 197.

²¹³ Which nonetheless was found earlier in the same section: 'At this point the Tribunal has to evaluate whether the impugned measures were "necessary" for the maintenance of public order and the protection of the essential security interests of Argentina within the meaning of the BIT.' (para. 189).

²¹⁴ Para. 197, citing *EC-Tyres*, para. 145

²¹⁵ My italics.

objective” in order to be necessary was not a precise determination in the WTO Appellate Body decision it cited (*Brazil-Tyres*). Rather, it was a phrase used by the AB to distinguish the necessity threshold of Article XX from Brazil’s claim that a measure that provided only a marginal or insignificant contribution to its stated objective could be considered necessary. Arguably, all of this is very far from the narrow necessity test in Art XI of the BIT.

The Tribunal then formulated a two-step analysis in applying the other test about whether Argentina had reasonably available alternatives that would have been

- 1) not in breach of the BIT, that might have been available when the Measures challenged were taken and that would have yielded equivalent results/relief and
- 2) whether Argentina could have adopted at some earlier time different policies, that would have avoided or prevented the situation that brought about the adoption of the measures challenged.’ [para 198.]

This two-step analysis resulted in a powerful conclusion in favor of Argentina. In all but one of the measures enacted by the Government,²¹⁶ the Tribunal held that its conduct in the face of the crisis ‘conformed by and large with the conditions required from derogating from its obligations under Art. XI of the BIT’.²¹⁷ While it is not my intention here to reassess the necessity-determination of these complex regulatory measures, it seems that the earlier formulation of the test certainly determined the result. For instance, to the extent that one follows the *Korea-Beef* description of different degrees of necessity,²¹⁸ it seems difficult to agree with the Tribunal that the one of the several complex mechanisms taken by Argentina that affected investors which it described as “appropriate and reasonable” (related to “pesification” and subsequent freezing of dollar-denominated term-deposits) could be said to fall within any reasonable reading of Article XI.

Most importantly for our purposes: in this case, too, what may have well been a desirable outcome was reached through an exercise of proportionality analysis that rested on a somewhat less than solid basis.

4. Conclusion.

I. The *Total* Approach

In the very recent award in *Total v. Argentina*, an Arbitral Tribunal had the chance to examine the events in Argentina during the 2001-02 economic crisis yet gain. While the legal questions in that case were, essentially, the same as in *Continental Casualty* above (though under the France-Argentina BIT), the approach was notably different and decidedly more logical. Firstly, the Tribunal examined specific breaches under the BIT and then it examined whether the necessity defense was available. In conducting the necessity analysis, the Tribunal did not, like in *Continental Casualty*, employ proportionality analysis but chose rather to follow the more common, and much narrower, approach found in Article 25 of the ILC Draft Articles on

²¹⁶ See para. 221 *et seq.* The reason for this difference, which concerned an offer to swap Treasury Bills against newly issued securities, was *inter alia* the late date in which it was offered, at which point Argentina’s financial conditions could no longer be described as a crisis, with a specific reference to Art. 25 (1) (i) of the ILC Articles on State Responsibility (‘the only way for a State to safeguard an essential interest against a grave and imminent peril’). *Continental* was awarded \$2.8 million out of a \$ 112 million claim. The specific breach was of the Fair and Equitable Treatment protection in Art. II(2)(a) of the BIT, see para. 266.

²¹⁷ Para. 233.

²¹⁸ See text accompanying note 202 above.

State Responsibility.²¹⁹ However, some form of proportionality analysis did find its way into the Tribunal's reasoning, chiefly under the fair and equitable treatment determination, as anticipated under 4.I above. Furthermore, this reasoning was less open for critique than the approaches I have explained above.

In essence, the Tribunal introduced a balancing approach in order to determine whether the same measures taken by Argentina in Continental Casualty were affecting Total, a French investor involved in the gas and petroleum sector, in a manner inconsistent with the Fair and Equitable Treatment of the BIT. While making this determination, the Tribunal seems to have construed the legal question so as to allow for a balancing approach that mitigates the 2-against-1 problem mentioned above.²²⁰ Even though the Fair and Equitable Treatment standard does not follow the structure of qualified norms, the Tribunal chose an approach that allowed for balancing anyway. Firstly, it asked whether Total had a legitimate expectation (a "right") in each of its different claims.²²¹ If not, the Fair and Equitable Treatment requirement would not be applicable at all. If it did have such legitimate expectations, then a balancing approach was necessary. This required the Tribunal to take into account not only the relations between the State and the investor, but also the "the context of the evolution of the host economy, the reasonableness of the normative changes challenged and their appropriateness in the light of a criterion of proportionality".²²² This allowed for differential treatment of the different measures taken by Argentina, and after having conducted this balancing exercise, some were regarded as a violation of the BIT, others not. It is submitted that the legitimacy-related aspects of investment treaty arbitration is taken better care of by this approach than any of those outlined above.

II. Taking the *Total* path forward?

This paper has examined the first forays into proportionality analysis by investment treaty tribunals. These analyses were introduced firstly through the citation of jurisprudence from other international law regimes, namely WTO and European human rights law. I have argued that they were introduced in investment treaty arbitration not as a legal necessity but as part of a larger trend and in order to mitigate legitimacy problems that seem to be particularly pervasive in the specific areas—indirect expropriations and necessity defenses—in which they were employed. As such, there is little reason to believe that proportionality analyses will not prove important for future tribunals as well, in particular as a new generation of investment treaties is being concluded that seems to be more apt for this technique. In this respect, I have aimed to show that proportionality analysis, when conducted properly, is a useful tool for any adjudicative institution to counter legitimacy-related criticism and I believe this holds true in investment treaty arbitration as well.

However, in this article I have been critical of the manner in which it has been applied thus far, because its introduction has seemed less solid than over-eager. I regard this as unfortunate, but am more convinced by the less experimental balancing approach taken recently in the *Total* award, which retains most of the strengths of the earlier approaches but few of their weaknesses. One would hope that this approach is followed by future Tribunals, because in so far as the field is marred by its perceived lack of legitimacy, the only sure way

²¹⁹ Paras. 220-224, 345, 442 (all necessity defenses were unsuccessful against the various claims by Total.)

²²⁰ *Supra*, text accompanying n. 119.

²²¹ Paras. 113-122.

²²² Para. 123.

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for arbitrators to help allay it is to avoid straying outside the confines of solid and persuasive legal reasoning and methodology.