

INVESTOR-STATE ARBITRATION:
PROPORTIONALITY'S NEW FRONTIER
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The arbitral world is at a crucial point in its historical development, poised between two conflicting conceptions of its nature, purpose, and political legitimacy. Formally, the arbitrator is an agent of the contracting parties in dispute, a creature of a discrete contract gone wrong. Yet, increasingly, arbitrators are treated as agents of a larger global community, and arbitration houses concern themselves with the general and prospective impact of important awards. In this paper, I address these questions, first, from the standpoint of delegation theory. In Part I, I introduce the basic "Principal-Agent" framework [P-A] used by social scientists to explain why actors create new institutions, and then briefly discuss how P-A has been applied to the study of courts. Part II uses delegation theory to frame discussion of arbitration as a mode of governance for transnational business and investment. In Part III, I argue that the International Center for the Settlement of Investment Disputes (ICSID) is presently in the throes of judicialization, indicators of which include the enhanced use of precedent-based argumentation and justification, the acceptance of third-party briefs, and a flirtation with proportionality balancing. Part IV focuses on the first wave of awards rendered by ICSID tribunals pursuant to Argentina's response to the crushing economic crisis of 2000-02, wherein proportionality emerged, adapted from the jurisprudence of the Appellate Body of the World Trade Organization.

INTRODUCTION

The arbitral world is at a crucial point in its historical development, poised between two conflicting conceptions of its nature, purpose, and political legitimacy. The larger questions addressed in this Article are revealing. To what extent are arbitrators Agents of contracting parties, and to what extent are they Agents of a larger global community? Should the International Center for the Settlement of Investment Disputes (ICSID), or any other arbitration house that claims to offer effective resolution of contractual disputes resist its own judicialization? Or is the judicialization of ICSID, and the consequent accretion of capacities to deliver "global governance," now all but inevitable? Should arbitrators balance the rights of investors against public interests when they assess State measures that allegedly violate protections under a Bi-Lateral Investment Treaty (BIT) and, if so, should they adopt proportionality analysis?

In this Article, I address these questions, first, from the standpoint of delegation theory. In Part I, I introduce the basic "Principal-Agent" framework (P-A) used by social scientists to explain why actors create new institutions, and then briefly discuss how P-A has been applied to the study of courts. Part II uses delegation theory to frame a response to the questions just posed.¹ The arbitral world, it is argued, faces a choice between two models of its own structure and function, indeed, its very identity. In Part III, I argue that ICSID is presently in the throes of judicialization, one indicator of which is a flirtation

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¹ Delegation theory is largely unknown in the scholarly discourse on transnational investment arbitration. I do not claim that delegation theory is superior to the more tradition ways of understanding arbitration, or that it should replace other conceptions. In my view, the P-A framework is only of value to the extent that it both (1) clarifies theoretically-relevant questions, and (2) stimulates research on these questions.

with proportionality balancing. Part IV focuses on the first wave of awards rendered by ICSID tribunals pursuant to Argentina's response to the crushing economic crisis of 2000-02.

The importance of the Argentina cases for the future of investor-State arbitration can hardly be exaggerated. The six awards issued to date² have adopted wildly inconsistent approaches to the most important politico-legal question raised in these cases. Namely, were the measures adopted by Argentina to meet the economic crisis "necessary" to preserve public order and security, and therefore "non-precluded measures" under Article XI of the U.S.-Argentina BIT³? Five tribunals answered this question directly: two accepted Argentina's "necessity" defense; three rejected it. For readers of this special issue, this series of awards deserves attention, not least, because it has placed the choice of adopting a mature version of the proportionality framework squarely on ICSID's agenda. Being deeply political, these challenges are not purely doctrinal.

This Article follows from prior research on the emergence of the proportionality framework and its consolidation as a global, best-practice standard for dealing with normative conflicts of a particular structure. In a recent paper, Jud Mathews and I have developed a theoretical explanation for why judges would find proportionality analysis attractive; we then traced its diffusion from German public law to national constitutional systems (Canada, South Africa, Israel), and to international regimes (the European Union, the European Convention on Human Rights, and the World Trade Organization).⁴ In a nutshell, we argued that proportionality provides judges with the most appropriate analytical procedure currently available for adjudicating disputes involving conflicts between two principles (or interests, or values) that possess the same rank in a normative hierarchy. The paradigmatic example is a conflict between (a) a pleaded right, and (b) a government measure that infringes upon that right, but is nonetheless permitted under some public interest exception. Such conflicts—of which the Argentina cases at ICSID represent one type—are among the most politically controversial cases that judges are asked to resolve.

² In chronological order: CMS Transmission Co. v. Argentine Republic, ICSID Case No. ARB/01/8, Award (May 12, 2005), *available at* http://www.icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC504_En&caseId=C4; LG&E Energy Corp. v. Argentine Republic, ICSID Case No. Arb/02/1, Decision on Liability (Oct. 3, 2006), *available at* http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC627_En&caseId=C208; Enron Corp., Ponderosa Assets, L.P. v. Argentine Republic, ICSID Case No. Arb/01/3, Award (May 22, 2007), *available at* <http://icsid.worldbank.org/ICSID/Index.jsp>; CMS Gas Transmission Company v. Argentine Republic, ICSID Case No. ARB/01/8, Decision of the *Ad Hoc* Committee on the Application for Annulment (Sept. 25, 2007), *available at* http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC687_En&caseId=C4; Sempra Energy Int'l v. Argentine Republic, ICSID Case No. Arb/02/16, Award (Sept. 28, 2007), *available at* http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC694_En&caseId=C8; Continental Casualty Company v. Argentina, ICSID Case No. ARB/03/9, Award (Sept. 5, 2008).

³ Treaty Concerning Reciprocal Encouragement and Protection of Investment, U.S.-Argentina, art XI, Nov. 14, 1991, SENATE TREATY DOC. 103-2 (1993) [hereinafter U.S.-Argentina BIT].

⁴ Alec Stone Sweet & Jud Mathews, *Proportionality Balancing and Global Constitutionalism*, 47 COLUM. J. TRANSNAT'L L. 73 (2008).

For powerful strategic reasons, judges tend to respond by adopting a balancing posture; and they use techniques associated with balancing to mitigate certain strategic dilemmas, the most important of which is the 2-against-1 problem.⁵ The social legitimacy of third-party dispute resolution rests on the perception of the parties that dispute resolvers will be neutral, vis-à-vis the parties, and will not be biased toward one value being pleaded as opposed to another. Yet each party seeks to prevail over the other. To the extent that the dispute resolver declares a winner, a two-against-one situation is created, which threatens to undermine the legitimacy of the proceeding and of the third party. Ad hoc balancing allows the dispute resolver to take a decision while making it clear, to present and future parties, that she might have decided otherwise if the facts had been different. More generally, balancing provides flexibility, enabling judges to adapt decisions to facts (rather than shoe-horning facts into rigid rules), and to fashion equitable judgments, reducing the losses of the loser as much as possible. Yet balancing has well-known strategic disadvantages. Most important, balancing fully exposes judges as lawmakers, and it shows that outcomes are substantively indeterminate, at a deep structural level. Proportionality embraces balancing, which includes, under the “necessity” phase of the sequence, a narrow-tailoring requirement (least-restrictive means testing). Proportionality also provides a semblance of a response to substantive indeterminacy, providing a fixed procedure for managing such disputes, as well as a stable framework for argumentation and justification.

The Argentine cases raise crucial issues that are as political as they are doctrinal. How should arbitral tribunals resolve clashes between investors’ rights, on the one hand, and a State’s interest or duty to respond to economic crisis, on the other? Although it is distinctly minority position, I argue that adopting proportionality would give ICSID tribunals important advantages in coping with the increasing politicization of investor-State arbitration.

I. PRINCIPALS AND AGENTS

Over the past three decades, P-A has emerged as a standard approach to research on institutions as diverse as the firm,⁶ State organs,⁷ and international regimes.⁸ In Economics, it is the dominant paradigm for analyzing problems of corporate governance and industrial organization; in Political Science, it is associated with “rational choice” approaches to government. Although scholars use it for varied purposes, P-A is popular for three main reasons. First, it explains the origin and persistence of institutions—or

⁵ For these and other considerations, *see id.* at 81-97.

⁶ *See* JEAN-JACQUES LAFFONT & DAVID MARTIMORT, *THE THEORY OF INCENTIVES: THE PRINCIPAL-AGENT MODEL* (2001); PAUL MILGROM & JOHN ROBERTS, *ECONOMICS, ORGANIZATION, AND MANAGEMENT* (1992).

⁷ *See, e.g.*, DELEGATION AND ACCOUNTABILITY IN PARLIAMENTARY DEMOCRACIES (Kaare Strom, Wolfgang Müller & Torbjörn Bergman eds., 2004).

⁸ *See, e.g.*, MARK POLLACK, *THE ENGINES OF EUROPEAN INTEGRATION: DELEGATION, AGENCY, AND AGENDA-SETTING IN THE EU* (2003); ALEC STONE SWEET, *THE JUDICIAL CONSTRUCTION OF EUROPE* ch. 1, 3, 4 (2004); Jonas Tallberg, *Delegation to Supranational Institutions: Why, How, and with What Consequences?*, 25 W. EUR. POL. 23 (2002).

modes of governance,⁹ if one prefers—in light of the specific functional demands of actors who need governance. Second, it offers ready-made, appropriate concepts that the analyst can adapt easily to virtually any governance situation. Third, it helps to organize empirical research on the dynamics of delegated governance, allowing the analyst to derive testable propositions about the consequences, *ex post*, of delegating in a particular form, *ex ante*. I outline a highly simplified version of the framework here, highlighting relevant features that are agreed-upon among scholars who use it, and apply it to courts.

The P-A approach dramatizes the relationship between Principals and Agents, against the background of a specified set of governance problems. *Principals* are those actors who create *Agents*, through a formal act in which the former confers upon the latter some authority to govern, that is, to take authoritative, legally-binding, decisions. The Agent governs to the extent that this authority is exercised in ways that impact upon the distribution of values and resources in the relevant domain of the Agent's competence. By assumption, the Principals are initially in control, in the strict sense that they have unconstrained discretion to constitute (or not to constitute) the Agent. Since the Principals are willing to pay the costs of delegation—which include expenditures of resources to design a new institution, and to monitor its activities *ex post*—it is assumed that the Principals expect the benefits of delegation to outweigh costs, over time. Put simply, delegation takes place in so far as it is functional for (i.e., “in the interest of”) Principals.

The most common rationales for delegation are also functionalist. Among other reasons, Principals choose to constitute Agents in order to help them:

(1) resolve commitment problems: as when the Agent is expected to work to enhance the credibility of promises made either between Principals, or between Principals and their constituents, given underlying collective action problems;

(2) overcome information asymmetries in technical areas of governance: wherein the Agent is expected to possess, develop, and employ expertise in the resolution of disputes and the formation of policy in a given domain of governance;

(3) enhance the efficiency of rule making: as when Principals expect the Agent to adapt law to situations (e.g., to complete incomplete contracts), while maintaining the authority to update policy in light of the Agent's efforts;

(4) avoid taking blame for unpopular policies: as when the Principals command their Agent to maximize specific policy goals that they know may sometimes be unpopular with important societal actors and groups.¹⁰

These logics will often overlap one another.

The Principals' capacity to control the Agent is a central preoccupation of the approach, bordering on obsession. The rationalist assumes that any Agent may have, or will develop over time, its own interests, and these will at times diverge from those of the Principals. To the extent that the Agent performs its appointed tasks in ways that were unforeseen and unwanted by the Principals, the Agent will undermine the social legitimacy of delegation (which is based on the *ex ante* preferences of Principals), while

⁹ I define governance as “the process through which the rule systems in place in any social setting are adapted to the needs and purposes of those who live under them.” Alec Stone Sweet, *Judicialization and the Construction of Governance*, 32 COMP. POL. STUD. 147 (1999).

¹⁰ See Mark Thatcher & Alec Stone Sweet, *Theory and Practice of Delegation to Non-Majoritarian Institutions*, 25 W. EUR. POL. 4 (2002).

producing unwanted policy that may be costly to eradicate. These losses—which I call “agency costs”—inhere in the delegation of discretion. Principals thus face a dilemma. In order for them to reap the benefits of delegation, they have to grant meaningful discretionary power to an Agent; but the Agent may act in ways that undermine the logic of delegating in the first place.¹¹

The analyst assumes that Principals share this anxiety. Principals will therefore seek to incentivize the Agent’s work in order to maximize benefits while limiting agency costs. In designing and reforming an institution, the Principals choose from a complex menu of options. Principals may give an Agent more or less authority to govern in a specific domain *ex ante*; they may create procedures enabling them to monitor the Agent’s decisions; and they may choose to retain some or no power to undo an Agent’s decisions *ex post*. This point can be formalized. Any Agent’s “zone of discretion”¹² is constituted by (1) the sum of delegated powers (discretion to take authoritative decisions) granted to the Agent, minus (2) the sum of control instruments, available for use by the Principals to constrain the Agent, or overturn its decisions.

The zone of discretion can be defined and assessed without regard to the Principals’ preferences and policy goals. Nonetheless, one expects such preferences to be fundamental to the choices made. If the Principals, for example, seek to bind their successors to a policy of low inflation, they may decide to create an independent Central Bank, with plenary powers over macro-economic policy, while insulating the Bank’s decision from interference by present and future elected officials. To use another example, if Principals are uncertain about the kind of policy they want, say, in a regulatory domain characterized by technical complexity and scientific risk, they may give an Agent the task of developing a regulatory framework as problems emerge and evolve, while retaining effective *ex post* controls. Generally, the more Principals seek to pre-commit themselves to specific outcomes or values, the more discretion they will delegate to an Agent, and the weaker will be *ex post* mechanisms of control. In contrast, the more Principals seek a rich range of policy alternatives from which to select, on an ongoing basis, the more they will devote resources to monitoring the Agent’s activities, and the more effective will be the *ex post* mechanisms of control.

The size of the zone of discretion also has implications for the strategic relationship between the Principals and their Agent. The smaller the zone of discretion, one might argue, the greater the Agent’s interest will be in monitoring and anticipating the Principal’s assessment of its activities. The analyst assumes that the Agent is more likely to take decisions that conform to the Principals’ policy preferences to the extent that the Agent wishes to avoid being censured and punished, or having its decisions overturned by the Principals. The larger the zone of discretion, however, the less credible is that threat. In some situations—which I label *trusteeship*—it is highly improbable or virtually impossible for Principals to overturn the Agent’s decisions. A further complication flows from the fact that, in many situations, the Principals are multiple actors whose preferences may change and diverge over time. Other things equal, the Principals are weaker vis-à-vis an Agent, the more they disagree among themselves about

¹¹ In some situations, the expected return to delegating to the Agent will be inversely proportional to limitations placed on the Agent’s discretion. Principals, after all, can choose to govern themselves, without the help of an Agent.

¹² See Thatcher & Stone Sweet, *supra* note 10, at 5-6.

the Agent's tasks and goals.

To illustrate, consider variation in the zone of discretion enjoyed by different types of courts. In a system of legislative sovereignty, the courts can be conceptualized as Agents of Parliament—the Principal. Their task is to enforce the various codes and statutes adopted by the legislator. The judge in such a system operates in a relatively narrow zone of discretion: Parliament can overrule undesirable judicial decisions by amending the statute, using normal legislative procedures (majority vote). Constitutional and supreme courts govern in a much wider zone of discretion. They have the authority to invalidate infra-constitutional norms, including statutes; and the constituent power made the decision rules governing constitutional amendment more complex and restrictive than those governing the making of legislation precisely in order to insulate the constitutional judge's decisions from the reach of political majorities in parliament. Wider still are the zones of discretion of the courts of many treaty regimes—including the European Court of Justice, the Appellate Body of the World Trade Organization, and the European Court of Human Rights.¹³ One of the peculiarities of treaty law, relative to most national legal systems, is that the decision rule governing the revision of the basic norms is unanimity among the contracting states.

I now depart somewhat from the classic P-A framework. In my view, the framework loses much of its relevance when applied to certain types of Agents, in particular, those whose decision making is insulated, as a legal or practical matter, from *ex post* controls. I prefer to apply a model of “trusteeship” to situations wherein the Principals have conferred expansive, open-ended “fiduciary” powers on an Agent.¹⁴ A trustee is a particular kind of Agent, one that possesses authority over those who have delegated in the first place. Note that the judge, in the system of legislative sovereignty, does not govern the parliament; he is an Agent of the parliament's will as expressed in statutory commands. Constitutional courts are trustee courts. They typically exercise fiduciary responsibilities with respect to the constitution; in most settings, they do so in the name of a fictitious entity: the sovereign People. The political parties in parliament are never Principals, with respect to the judge of the constitution, but are themselves subject to the constitutional law, as interpreted by the constitutional judge.

Mapping out a court's zone of discretion does not tell us how the court will actually use its powers. Some predictions are nonetheless implied. Other things equal—though conditions and context are rarely equivalent—the wider a court's zone of discretion—the more likely it will be that it will come to dominate the evolution of the system as a whole. We can expect a trustee court to do so in so far as three conditions are met. First, the court must have a case load. If actors never bring cases to the court, it will accrete no influence over the system. Second, once activated, judges must resolve these disputes and *give defensible reasons* in justification of their decisions. If they do, one output of adjudication will be the production of a case law, or *jurisprudence*, which is a record of how the judges have interpreted and applied the law. Third, those who are

¹³ See Alec Stone Sweet, *Constitutionalism, Legal Pluralism, and International Regimes*, 16 IND. J. GLOBAL LEGAL STUD. 621 (2009).

¹⁴ See Alec Stone Sweet, *Constitutional Courts and Parliamentary Democracy*, 25 W. EUR. POL. 77 (2002) (building on the contributions of Giandomenico Majone, *Two Logics of Delegation: Agency and Fiduciary Relations in EU Governance*, 2 EUR. UNION POL. 103 (2001), and Terry Moe, *Political Institutions: The Neglected Side of the Story*, 6 J. L. ECON & ORG. 213 (1990)).

governed by the law must accept that meaning is (at least partly) constructed through this jurisprudence, and they must use or refer to relevant case law in future disputes. None of these conditions can be taken for granted as naturally occurring; they are, rather, part of a process called *judicialization*.¹⁵ The next section applies these ideas to transnational arbitration.

¹⁵ See Stone Sweet, *supra* note 9.

II. JUDICIALIZATION AND CONSTITUTIONALIZATION

There is no single or best way to use delegation theory. The analyst must make choices about how to model any specific P-A relationship, and these choices will have consequences on how the analysis proceeds. In this section, I use the P-A construct to conceptualize transnational commercial and investment arbitration in two distinct ways. I expect substantial disagreement among readers about which type of model is the (descriptively or normatively) appropriate model, given that this disagreement maps onto current debates about arbitration's underlying nature and purpose.

The first model would be constructed from the classic assumptions of freedom of contract. I use the conditional tense because I am not aware of other efforts to apply a P-A to arbitration, and what follows is a simplified and abbreviated account.

A P-A relationship is constituted when two contracting parties (the Principals) confer upon an arbitrator (the Agent) the authority to resolve any dispute that arises under the contract. The Principles are also free to select the law governing the contract and the procedures to be used in the dispute settlement process, which are assumed to constrain the arbitrator. To be sure, arbitration has been steadily institutionalized over the past five decades. Rules and procedures have been substantially codified by the major arbitration houses;¹⁶ it is now settled doctrine that arbitral clauses are separable from the main contract;¹⁷ in many parts of the world, the scope of judicial review of arbitral awards has been radically reduced;¹⁸ and issues of *Kompetenz-Kompetenz* have been largely resolved in the arbitrator's favor.¹⁹ But these developments can be said to push in the same direction: to enhance the Agent's authority to enforce the parties' commitments in the face of a party tempted to renege once a contractual dispute erupts.

In this account, an arbitration clause is a commitment device that the parties use to help them resolve the various collective action problems associated with contracting. The legitimacy of arbitral power is not initially problematic, since it is based on an act of delegation to which the parties have freely consented. Further, the authority of the arbitrator is limited to the domain of activity governed by the contract itself. The arbitrator will typically interpret contractual provisions in light of some law of contract, and she will apply these interpretations to resolve the dispute. In so far as she makes law through interpretation, reason-giving, and application, this lawmaking is retrospective and particular, in that it applies only to a dispute involving a pre-existing contract between two parties. Put negatively, an "unjust" arbitral ruling is much like a bad business deal, or a good deal gone bad: Both are limited to the sphere of a discrete contractual setting.

¹⁶ All established arbitration houses have published rules that are mandatory for those who choose to use their services.

¹⁷ That is, the validity of the arbitral clause is not affected by the legal nullity of the contract of which it is a part. In essence, the doctrine forecloses moves by one of the parties to the contract to avoid arbitration by pleading the contract's nullity.

¹⁸ That is, the legal validity of arbitral awards, and thus their enforceability in national law, is presumed.

¹⁹ *Kompetenz-Kompetenz* refers to the formal competence of a jurisdiction to determine its own jurisdiction, or the jurisdiction of another organ. Modern arbitration statutes and case law largely accept that the arbitrator possesses the authority to fix the scope of its own jurisdiction, subject of course to the will of the contracting parties.

A second type of model would accept as given most of the precepts and logics of the first model, but would reject the view that the arbitrator is merely the Agent of the contracting parties. Instead, the analyst adds a level of law and institutional complexity to the equation in order to show that the arbitrator can be meaningfully conceptualized as an Agent of the transnational commercial and investment community. Consider the case of transnational commercial arbitration in which the parties to the contract are both private firms. The parties have delegated to the arbitrator, thus constituting a standard, contract-based P-A relationship. But, I would insist, this act of delegation does not take place in a vacuum, or in anarchy, but in the context of an increasingly elaborate legal system.

With the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards,²⁰ signatory States made national courts the public guarantors of private arbitral authority, with respect to recalcitrant parties seeking to quash foreign arbitral awards in national jurisdictions. In the United States, a series of judicial decisions have famously embraced this role, even so far as recognizing the legitimacy of foreign arbitral awards that apply mandatory U.S. law. In Europe too (but primarily through changes in the relevant statutes), the public policy and in-arbitrability exceptions contained in the New York Convention have been narrowed to the point of practical irrelevance. A scholarly war now rages between those who, in effect, consider national courts to be the Agents of foreign arbitrators, and those who would see foreign arbitrators as, in effect, Agents of States who have determined that arbitration is good for business, and therefore in the national interest. This controversy is evidence, again, of increasing systemic complexity. However, one need not take sides in this debate to make the crucial point: any transnational contract that contains an arbitration clause, and any transnational commercial arbitration, is embedded in a larger system of law.

If the arbitrator is not merely the Agent of two contracting Principals, but an Agent of the greater community, then one might ask if (or assume that) the arbitrator has a responsibility to take into account the community's interests in decisions. There exists a great deal of evidence showing that this is, in fact, happening. More and more decisions are being published, and certain kinds of decisions are treated by subsequent litigators as having precedential value.²¹ Scholars refer to the emergence of an "arbitral common law," tailored to the needs of specific categories of traders, built as the common law has traditionally been built, through reasons given that subsequently congeal as precedent.²² Not surprisingly, the question of whether the creation of appellate instances for the arbitral system is being actively debated.²³ Each of the major arbitral tribunals requires that arbitrators give reasons for decisions; and each has developed mechanisms

²⁰ The Convention is widely recognized as a foundation instrument of international arbitration and requires courts of contracting States to give effect to an agreement to arbitrate when seized of an action in a matter covered by an arbitration agreement and also to recognize and enforce awards made in other States, subject to specific limited exceptions. The Convention entered into force on June 7, 1959.

²¹ See KLAUS BERGER, *THE CREEPING CODIFICATION OF THE LEX MERCATORIA* 57-74, 214-20 (1999).

²² See THOMAS CARBONNEAU, *LEX MERCATORIA AND ARBITRATION: A DISCUSSION OF THE NEW LAW MERCHANT* 16-18 (1997); Alec Stone Sweet, *The New Lex Mercatoria and Transnational Governance*, 13 J. EUR. PUB. POL'Y 627, 642-43 (2006).

²³ See Part III, *infra*.

for reviewing these reasons prior to approving awards. In short, arbitrators are becoming—if with some hand-wringing and reluctance—more like courts.²⁴

Thus, in contrast to the first model, the second type of model does not assume that arbitrators only make law that is retrospective and particular, or encompassed entirely in the contract. Arbitrators can and should be involved in lawmaking that is also general and prospective. Whereas proponents of the first model must worry that such lawmaking would undermine the legitimacy of the Agent, advocates of the second model believe that the social legitimacy of arbitration is inextricably tied to the question of how arbitrators deal with various problems faced by the community, including larger issues of systemic legitimacy. It is telling that the insistence on giving reasons, the accretion of precedent, and calls for supervisory or appellate review, are justified in the name of “justice.” The major houses are keenly aware that the legitimacy and viability of arbitration will heavily depend upon their capacities to provide a modicum of legal certainty (justice) for both present *and* future users of the system.

I now turn to the main topic of the Article, transnational investment arbitration, wherein one party to the arbitration is a State. The standard conception of investment arbitration closely resembles that of *inter partes* commercial arbitration (essentially my first model). Investment arbitral tribunals are established on an *ad hoc* basis, and their mandate is specifically limited to the settlement of the disputes that have been submitted to them. Further, tribunals take authoritative decisions whose reach is limited to the parties. Still, in my view, the first model is doomed, to the extent that the judicialization process proceeds.²⁵

Finally, some scholars have taken a further step, asking whether Investor-State arbitration has been, or is being, “constitutionalized.”²⁶ There are a number of ways in which the field may be said to be *constitutional*. First, the ICSID is a global institution that governs by virtue of, and with reference to, constituting law that has been ratified by more than 140 sovereign States. The ICSID Convention, Regulations, and Rules²⁷ comprise that constitution, and the scope of the Center’s authority is unrivalled in its domain of activity. Most stable, treaty-based organizations would probably be considered constitutional under this definition.²⁸

The second, forcefully advocated by, among others Ulrich Petersmann, takes a systemic, public international law perspective. This view acknowledges that the system is

²⁴ See Florian Grisel, *Control of Awards and Re-centralisation of International Commercial Arbitration*, 25 CIV. JUST. Q. 166 (2006); Stone Sweet, *supra* note 22, at 641-43.

²⁵ It deserves mention that the ICSID has always been considered to be more of a “court” than an “arbitral body” in the classic sense. Barton Legum, *La Réforme du CIRDI : Vers une Juridictionnalisation de l'Arbitrage Transnational?*, in *OU VA LE DROIT DE L'INVESTISSEMENT ? DÉSORDRE NORMATIF ET RECHERCHE D'ÉQUILIBRE* 283 (Ferhat Horchani ed., 2006).

²⁶ See HUMAN RIGHTS IN INTERNATIONAL INVESTMENT LAW AND ARBITRATION (Pierre-Marie Dupuy, Francesco Francioni, & Ernst-Ulrich Petersmann eds., 2009), which is organized around this issue; in particular the chapter by Ernst-Ulrich Petersmann, *Constitutional Theories of International Economic Adjudication and Investor-State Arbitration*, *id.* at 137.

²⁷ The ICSID Convention, including the Report of the World Bank Executive Directors on the Convention, as well as the ICSID Regulations and Rules, as amended and in effect from April 10, 2006, available at <http://icsid.worldbank.org/ICSID/ICSID/RulesMain.jsp>.

²⁸ That is, the organization was constituted by a founding document and the legal system is organized by what Hart called “secondary rules,” see H.L.A. HART, *THE CONCEPT OF LAW* 92-93, 94, 114 (2d ed. 1994).

not constitutional according to standard ways of thinking drawn from national systems, in so far as there is no unified sovereign in the system, and there is no agreed-upon hierarchy of norms that securely integrates international and national legal orders. In a phrase, the system remains pluralistic. Nonetheless, proponents of this perspective seek to identify those elements that can be characterized as “constitutional,” and then argue that these elements deserve to be given special status in transnational and international legal process. The most commonly invoked elements are *jus cogens* norms, basic human rights, and procedural guarantees associated with due process and access to justice.²⁹ What is being argued is that these norms constitute an overarching frame, a theoretically-supposed “constitution,” within which one finds discrete hierarchies, both national and Treaty-based. These systems interact with one another pluralistically, with reference to the frame. One then focuses on the dynamics of pluralist interaction—on inter-regime conflict, resistance, diplomacy, and cooperation—to find evidence that the system is indeed constitutional, and to identify mechanisms of systemic construction.³⁰

In this account, the arbitrator as Agent, and the ICSID arbitrator in particular, is bound to interpret and apply these norms when they are material to any arbitral proceeding. The duty flows from the very fact that these norms are constitutional, despite the fact that their source is public international law. And it is supplemented and reinforced by other norms, such as the call in the Preamble of the Vienna Convention on the Law of Treaties³¹ that disputes be resolved “in conformity with the principles of justice.” Following this line of argument, the ICSID arbitrator is always both an Agent of the contracting parties and an Agent of the greater investment community and, at least at times, an Agent of the global legal (constitutional) order. I support this formulation, not least as a predicted outcome of the judicialization process.

III. THE CASE OF THE ICSID

I argue (Part I) that the wider is a court’s zone of discretion, the more likely it will dominate the evolution of the system as a whole, through its case law. Investor-State arbitral tribunals are *ad hoc* instances, rather than courts staffed by permanent, professional judges; and the ICSID system is not hierarchically-organized, with an appellate jurisdiction at its summit. Yet from the point of view of judicialization, there are intriguing structural features. ICSID tribunals are the judges of their own competence (Article 41 of the ICSID Convention) and have the power to decide on any question of procedure that has not been covered by the ICSID Convention, or the Arbitration Rules, or any rules agreed by the parties (Article 44 of the ICSID Convention). At the same time, the parties have limited *ex post* control instruments at their disposal. Disgruntled parties are pushed into ICSID annulment committees (Article 52 of the ICSID Convention), with highly restricted access to challenges of awards in domestic courts (Article 54 of the ICSID Convention). Most important, the ICSID system meets each of

²⁹ Although they might object, I read Erika de Wet and Ernst-Ulrich Petersmann to be representative of this view. See Ernst-Ulrich Petersmann, *Multilevel Trade Governance Requires Multilevel Constitutionalism*, in CONSTITUTIONALISM, MULTILEVEL TRADE GOVERNANCE AND SOCIAL REGULATION 5 (C. Joerges & Ernst-Ulrich Petersmann eds., 2006); Erika de Wet, *The International Constitutional Order*, 55 INT’L & COMP. L. Q. 51 (2006).

³⁰ See also Stone Sweet, *supra* note 13.

³¹ Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331.

the three conditions stipulated at the close of Part I: it has an important and steadily expanding case load; tribunals, who are under a duty to give reasons for their decisions (Article 52(1)(e) of the Rules) are, in fact, building an increasingly sophisticated case law; and, today, states and investors argue their cases primarily in terms of this case law, helping to legitimize its precedential status.

As I argue in Part II, the judicialization of Investor-State arbitration implies a move from the first to the second model of delegation (Part II). I now give empirical content to this claim by identifying specific indicators of judicialization: precedent; the adoption of balancing techniques; the admission of *amicus* briefs; and the push for appellate supervision of arbitral awards. Each of these indicators can be assessed, on their own and in combination, as factors in the judicialization of Investor-State arbitration.

A. PRECEDENT

Arbitral tribunals are actively engaged in building *jurisprudence*: a judge-made, precedent-grounded, law of investment arbitration, created in order to stabilize (potentially explosive) strategic environments, to entrench specific frameworks of argumentation, and to legitimize their own lawmaking.³² Here I focus on ICSID practice.

ICSID tribunals must give reasons, but they are not obligated to follow the past reason-giving of prior tribunals. Article 53 of the ICSID Convention states that: “The award shall be binding on the parties,” which echoes, in part, Article 59 of the Statute of the International Court of Justice:³³ “The decision of the Court has no binding force except between the parties and in respect of that particular case.” Nonetheless, in *AES v. Argentine* (2005), the Tribunal developed a nuanced theory of the role of precedent in ICSID. The Tribunal denied that it was strictly bound by past decisions in any formal sense, while suggesting why arbitrators would find prior rulings, on point, of “real interest”:

Each tribunal remains sovereign and may retain, as it is confirmed by ICSID practice, a different solution for resolving the same problem; but decisions on jurisdiction dealing with the same or very similar issues may at least indicate some lines of reasoning of real interest; this Tribunal may consider them in order to compare its own position with those already adopted by its predecessors and, if it shares the views already expressed by one or more of these tribunals on a specific point of law, it is free to adopt the same solution.³⁴

More recently, tribunals have begun to refer to a “duty” to respect precedent. Consider *Saipem Spa v. Bangladesh* (2007):

The Tribunal considers that it is not bound by previous decisions. At the same time, it is of the opinion that it must pay due consideration to earlier decisions of international tribunals. It believes that, subject to compelling contrary grounds, it has a duty to adopt solutions established in a series of consistent cases. It also believes that, subject to the specifics of a given treaty and of the circumstances of the actual case, *it has a duty to seek*

³² Martin Shapiro & Alec Stone Sweet, *Judicial Law-Making and Precedent*, in ON LAW, POLITICS AND JUDICIALIZATION 90 (2002).

³³ The Statute of the International Court of Justice, June 26, 1945, 3 Bevans 1179.

³⁴ *AES Corporation v. Argentine Republic*, ICSID Case No. ARB/02/17, Award, para. 30 (Apr. 26, 2005).

*to contribute to the harmonious development of investment law and thereby meet the legitimate expectations of the community of States and investors towards certainty of the rule of law.*³⁵

The Tribunal in *Saipem Spa* justified these *dicta* in terms congruent with my second model, openly acknowledging that multiple forms of delegation and agency are nested within one another. In addition to resolving a discrete investment dispute, a central task of the Tribunal's is to enhance legal certainty for the community as a whole. It will do so through rendering something akin to formal justice—*like cases shall be decided in like fashion*. The Tribunal portrays this second form of delegation as tacit, but irresistible. The social demand for precedent flows from the “legitimate expectations” of States and investors for stability and coherence.

It is today indisputable that “a *de facto* doctrine of precedent”³⁶ governs investor-State arbitration: the parties intensively argue the substance and relevance of prior ICSID rulings, which Tribunals accept as persuasive authority, and then cite as supportive justification for their own rulings.³⁷

B. BALANCING AND PROPORTIONALITY

A second indicator of judicialization—or, the gradual entrenchment of investment arbitration as a stable system of governance in the field of foreign direct investment—is the deployment, by arbitrators, of modes of reasoning and doctrinal frameworks developed by courts. Most dramatically, tribunals are in the process of embracing balancing and proportionality.

For sound strategic reasons, investment arbitrators have constructed the “fair and equitable treatment” standard [FETS]³⁸ as a master tool for dealing with investment disputes. Indeed, arbitrators today use the standard as a kind of multi-purpose, umbrella principle that allows them to invoke and apply a wealth of sub-principles, including: good faith; access to justice and due process; regulatory transparency; non-arbitrariness, non-discrimination, and reasonableness; and the legitimate expectations of both parties. Among other functions, the FETS allows arbitrators to consider a wider range of elements than would normally be plausible under the tests for expropriation or regulatory takings (indirect expropriation); and the FETS facilitates the tailoring of appropriate

³⁵ *Saipem S.p.A. v. People's Republic of Bangladesh*, ICSID Case No. ARB/05/07, Decision on Jurisdiction and Recommendations on Provisional Measures, para. 67 (Mar. 21, 2007) (emphasis added A.S.S.). The Tribunal in *Victor Pey Casado et Fondation “Presidente Allende” c. République du Chili*, Affaire CIRDI No. ARB/98/2, Sentence arbitrale, para. 119 (May 8, 2008), repeated the formula in French, at ¶119.

³⁶ Domenico Di Pietro, *The Use of Precedents in ICSID Arbitration: Regularity or Certainty?*, 10 Int'l Arb. L. Rev. 96 (2007).

³⁷ In 2006, a second sentence was added to Rule 48, which now reads: “The Centre shall not publish the award without the consent of the parties. The Centre shall, however, promptly include in its publications excerpts of the legal reasoning of the Tribunal.”

³⁸ The FETS is found in virtually every Bi-Lateral Investment treaty. The American and Canadian version, found in the Model BIT, provides that: “Each party shall accord at all times to covered instruments fair and equitable treatment, in accordance with customary international law ...” The standard European provision (Dutch, German, Swedish, among others) states that: “Investors and investments of each contracting party shall at all times be accorded fair and equitable treatment in the territory of the other contracting state.”

remedies.³⁹ What is important for my purposes is that the FETS organizes an approach to the kind of disputes in which I am interested here, namely, those involving tensions between (a) an investor's rights (including legitimate expectations in investment security) and (b) the State's legitimate interest in regulating for the public good (including its expectations that investors will be good corporate citizens). Using the FETS in this way pushes tribunals toward balancing.

Balancing pushes arbitrators toward proportionality.⁴⁰ Tribunals find balancing attractive because of its scope and flexibility—it allows arbitrators to “see” the entire contextual field and to narrow or expand their intervention as required. Proportionality analysis will determine what the investor and the State can reasonably expect from the other, and what is arbitrary or unfair. Balancing under the FETS also makes it possible for arbitrators to incorporate concerns for third party interests. Thus, Francioni argues that “a progressive interpretation of the ‘fair and equitable standard’, ... entails that the investor who seeks equity for the protection of his investment must also be accountable, under principles of equity and fairness, to the host state's population affected by the investment.”⁴¹ Arbitrators who take this approach end up balancing the “interests of the investor and the interests of individuals and social groups who seek judicial protection against possible adverse impacts of the investment on their life or their environment,”⁴² or human rights. Although the FETS enhances arbitral flexibility, its very elasticity raises anxieties about (a) the scope of arbitral authority (can it ever be constrained at the *ex ante* contractual moment?), and (b) the determinacy of rulings (can arbitrators always get to *any* decision they want?). If one accepts that these worries are well-founded, then one can also see why the adoption of proportionality would make sense, in so far as it would inject a measure of analytic, or procedural, determinacy to the balancing exercise. Moreover, proportionality, properly used, requires arbitrators to reduce the losses accruing to the loser as much as is legally possible, thus enhancing their legitimacy.⁴³

Proportionality is an analytical framework first developed by administrative and constitutional courts in order to manage legal disputes of a particular structure (see the introduction to this Article).⁴⁴ In investor-State disputes, a move toward balancing would entail both the recognition of an investor's property rights and a “public interest” defense available to the State. In effect, the parties acknowledge that measures taken by the defendant State have infringed the investor's rights, but that hindrance may nonetheless be mitigated or justified to the extent that the measures taken were not arbitral, and were meant to serve a proper public good. Arbitrators using the proportionality framework will deploy means-ends testing to evaluate the impact of the State's measures on the

³⁹ KATIA YANNACA-SMALL, FAIR AND EQUITABLE TREATMENT STANDARD: RECENT DEVELOPMENTS, IN STANDARDS OF INVESTMENT PROTECTION 111-30 (August Reinisch ed., 2008).

⁴⁰ I recognize that this view is controversial among scholars.

⁴¹ Francesco Francioni, *Access to Justice, Denial of Justice, and International Investment Law*, 20 EUR. J. INT'L L. 729, 739 (2009).

⁴² *Id.*

⁴³ This will be so to extent that the ruling is disciplined by Alexy's “law of balancing”: “The greater the degree of non-satisfaction of, or detriment to, one principle, the greater must be the importance of satisfying the other.” ROBERT ALEXY, A THEORY OF CONSTITUTIONAL RIGHTS 102 (Julian Rivers trans., Oxford University Press, 2002) (1986). *See also id.* at 47 (on principles as “optimization” requirements); Stone Sweet & Mathews, *supra* note 4.

⁴⁴ Stone Sweet & Mathews, *supra* note 4.

investment; they will weigh the investor's rights against the public interest being pleaded; and their conclusions will bear upon their dispositive ruling and remedies.

No arbitral tribunal referred to proportionality, even implicitly, before 2000. In that year, a NAFTA tribunal, in the case of *S.D. Myers v. Canada*, gave a restrictive interpretation of the FETS contained in the NAFTA⁴⁵ (Article 1105, on the authority of domestic entities to regulate matters within their borders):

The Tribunal considers that a breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders.⁴⁶

Subsequently, in *Saluka v. Czech Republic* (2006), an UNCITRAL arbitral tribunal referred to the obligation, under the FETS, to balance the interests of the parties: No investor may reasonably request that the circumstances prevailing at the time the investment is made remain totally unchanged. In order to determine whether frustration of the foreign investor's expectations was justified and reasonable, the host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well. [...] The determination of a breach of Article 3.1 by the Czech Republic therefore requires a weighing of the Claimant's legitimate and reasonable expectations on one hand and the Respondent's legitimate regulatory interests on the other.⁴⁷

Since 2003, ICSID arbitrators have pushed further, explicitly adopting the proportionality principle while citing the European Court of Human Rights (ECtHR)⁴⁸ and its case law as a source. The ECtHR uses, and requires national courts to use, proportionality analysis when it adjudicates the qualified rights found in Articles 8-11 and 14 of the European Convention on Human Rights, and when it deals with the right to property in Protocol No. 1. In what appears to be the leading ICSID holding on the matter, *Tecmed v. Mexico*, an ICSID (Additional Facility), the tribunal cited two ECtHR rulings in assessing State's actions in light of the public interest they pursue, then declared that: "There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure."⁴⁹ In *Azurix v. Argentine* (2006), another tribunal referred to ECtHR jurisprudence, *S.D. Meyers*, and *Tecmed v. Mexico*, to justify employing "the

⁴⁵ North American Free Trade Agreement (NAFTA), 1992, *reprinted in* 32 I.L.M. 289 (1993).

⁴⁶ *S.D. Myers, Inc. v. Government of Canada*, NAFTA Arbitration, Partial Award, para. 263 (Nov. 13, 2000).

⁴⁷ *Saluka Investments BV v. The Czech Republic*, UNCITRAL Case, Partial Award, paras. 305-06 (Mar. 17, 2006).

⁴⁸ Convention for the Protection of Human Rights and Fundamental Freedoms, Nov. 4, 1950, 213 U.N.T.S. 222 [hereinafter ECHR]. Section II, Article 19(2) of ECHR establishes the European Court of Human Rights [hereinafter ECtHR].

⁴⁹ *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/02, Award, para. 122 (May 29, 2003).

*public purpose criterion as an additional criterion to the effect of the measures under consideration ...*⁵⁰

C. THIRD PARTY PARTICIPATION

The participation of *amicus curiae* in proceedings comprises a third indicator of the arbitrator as “Agent-of-the-Community.” *Amici* briefs, by definition, represent and articulate diffuse, social interests.

As recently as 2003, ICSID tribunals routinely denied third parties leave to submit briefs and to otherwise participate in proceedings. In *Aguas del Tunari v. Bolivia*, the Tribunal invoked the core elements of my first model of delegation in explicit terms:

[I]t is the Tribunal’s unanimous opinion that [requests to submit *amici* briefs] are beyond the power or authority of the Tribunal to grant. The interplay of the two treaties involved [...] and the consensual nature of arbitration [locates] the control of [this] issue ... with the parties, not the Tribunal. [T]he Tribunal ... does not, absent the agreement of the Parties, have the power to join a non-party to the proceedings; to provide access to hearings to non-parties and, *a fortiori*, to the public generally; or to make the documents of the proceedings public.⁵¹

In 2006, two tribunals decided otherwise, on the basis of inherent discretion. In *Aguas Argentinas v. Argentine* and *Aguas Provinciales v. Argentine*, arbitrators interpreted the last sentence of Article 44 of the Rules:⁵² “If any question of procedure arises which is not covered by ... the Arbitration Rules or any rules agreed by the Parties, the tribunal shall decide the question”—as conferring “residual power to the Tribunal to decide” to accept *amicus* briefs or not.⁵³ In response, the Rules were amended (new Rule 37 (2)) to confer on tribunals the authority to allow accept such briefs submissions, and to allow external observers to attend hearings (amendment of Rule 32 (2)). Rule 37(2) was the object of extensive interpretation in an order issued by the *Suez v. Argentina* Tribunal.⁵⁴ The order laid down an analytical process, replete with a series of tests, for

⁵⁰ *Azurix Corp. v. Argentine Republic*, ICSID Case No. ARB/01/12, Award, paras. 311-12 (July 14, 2006).

⁵¹ *Aguas del Tunari, SA v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Letter from the President of the Tribunal (Jan. 23, 2003).

⁵² Article 44 of the ICSID Convention: “If any question of procedure arises which is not covered by this Section or the Arbitration Rules or any rules agreed by the parties, the Tribunal shall decide the question.” Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, art. 44, Mar. 18, 1975, 17 U.S.T. 1270, 575 U.N.T.S. 160.

⁵³ *Aguas Argentinas, S.A., Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v. Argentine Republic*, ICSID Case No. ARB/03/19, Order in Response to a Petition for Transparency and Participation as *Amicus Curiae*, para. 10 (May 19, 2005); *Aguas Provinciales de Santa Fe S.A., Suez, Sociedad General de Aguas de Barcelona S.A. and InterAguas Servicios Integrales del Agua S.A. v. Argentine Republic*, ICSID Case No. ARB/03/17, Order in Response to a Petition for Participation as *Amicus Curiae*, para. 11 (Mar. 17, 2006).

⁵⁴ *Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/03/19, Order in Response to a Petition by Five Non-Governmental Organizations for Permission to Make an *Amicus Curiae* Submission, (Feb. 12, 2007) , laying down an analytical process and a series of tests for determining admissibility of *amicus* briefs. Among other things, the Tribunal held that briefs must address issues of substantial “public interest” in a case that involves

determining admissibility of *amicus* briefs. Among other things, the Tribunal held that briefs must address issues of substantial “public interest” in a case that involves public goods. As Francioni notes, these changes have the potential to anchor “the emergence ... of the idea of civil society” in the arbitral world.⁵⁵

D. APPEAL

A fourth indicator of judicialization is the demand for appellate supervision, given that there is no appellate instance for Investor-State arbitration. Traditional features of arbitration, including the *inter partes* nature of the contract, the ad hoc scope of a tribunal’s jurisdiction and composition, and the final character of decisions, militate against appeal. Moreover, the first model of arbitral agency forcefully denies the need for a “vertical system of control”⁵⁶ of arbitral awards. As a former Chief Justice of the United States has stressed, one important “advantage of arbitration is that [the] process usually need not produce a body of decisional law which will guide lawyers and clients as to what their future conduct ought to be.”⁵⁷ As we have seen, however, ICSID tribunals are behaving more and more like courts, building and using precedent, balancing, and considering wider collective interests of various sorts in their procedures and rulings. Cast in the light of the second model of delegation, the issue of appeal is inevitably raised.

Appeal has several well-known functions.⁵⁸ Appeal provides losing parties with cathartic opportunities to defend their interests. And it serves the goal of achieving legal certainty and doctrinal coherence, to the extent that hierarchy and supervision increase the consistency of decisions at first instance. Both rationales may serve to enhance the overall legitimacy of the system. In the ICSID context, appeal may be attractive for further reasons. Investor-State arbitration is of huge significance in today’s globalized world; the monetary stakes involved are typically high; the good reputations of large multi-national firms and states are at risk; and important disputes will always involve significant social interests. It may be, as a renowned practitioner has argued, that the investment community needs courageous arbitrators who are willing to think and to make law creatively, in the interest of the community, and in light of social and economic change. Brave judges “will inevitably make mistakes,” Van Vechten Veeder writes, and, given the inevitability of mistakes, “[one] need[s] an appellate system.”⁵⁹

In any case, as judicialization proceeds, the demand for appeal will grow. Not surprisingly, there is no shortage of proposals on the table, three of which deserves mention. A first consists in the creation of a standing court of appeal, an “*ICSID Appeals*

public goods. For an excellent analysis of this order, see Epaminontas Triantafyllou, *Amicus Submissions in Investor-State Arbitration after Suez v. Argentina*, 24 J. Arb. Int’l 571 (2008).

⁵⁵ Francesco Francioni, *Access to Justice, Denial of Justice, and International Investment Law*, in HUMAN RIGHTS IN INTERNATIONAL INVESTMENT LAW AND ARBITRATION, *supra* note 26, at 63, 76.

⁵⁶ BERGER, *supra* note 21, at 73.

⁵⁷ William Rehnquist, *A Jurist’s View of Arbitration*, 32 ARB. J. 1, 5 (1977).

⁵⁸ Martin Shapiro, *Appeal*, 14 L. & SOC’Y REV. 629, 631 (1980).

⁵⁹ Van Vechten Veeder, *The Necessary Safeguards of an Appellate System*, 2 TRANSN’L DISPUTE MGMT. 7 (2005).

Facility,”⁶⁰ or a chamber of the International Court of Justice acting as a “*Supreme Investment Court*.”⁶¹ A second proposal would create a permanent body that would answer preliminary questions raised on an issue-by-issue basis by arbitrators, as the European Court of Justice does under Article 234 of the Rome Treaty.⁶² A third aims at building on existing arrangements, modeling an appellate jurisdiction on the ICSID ad hoc annulment committees.⁶³ As discussed in the next section, ICSID annulment committees have the authority to quash awards only on a set of narrow grounds, and these grounds do not include a tribunal’s failure to interpret the controlling law correctly.

IV. PROPORTIONALITY’S NEW TERRAIN: ICSID AND THE ARGENTINA CASES

Part IV outlines an argument for the view that the world of Investor-State arbitration is being judicialized. One has good reasons to be skeptical, in particular, of the contention that tribunals are moving toward adopting proportionality. At best, the case law cited shows only that a handful of arbitral tribunals have thus far acknowledged that they balance under the FET standard, citing the ECHR in the process. But these cases do not exhibit a sophisticated understanding of proportionality analysis. Instead, tribunals invoked proportionality timidly, and they did not follow a step-by-step procedure. As important, they declined to provide the kind of scholastic exposition, or doctrinal justification, which a self-conscious doctrinal move toward proportionality might have generated.⁶⁴

The Argentina cases have placed the proportionality question—whether and how to use proportionality—at the top of the ICSID agenda. In this section, I trace the curious, non-linear process that produced this outcome.⁶⁵ There are reasons to think that how ICSID answers this question will be critical to its viability as a system of governance.

⁶⁰ ICSID SECRETARIAT, POSSIBLE IMPROVEMENTS OF THE FRAMEWORK FOR ICSID ARBITRATION 14 (2004).

⁶¹ A. Qureshi, *An Appellate System in International Investment Arbitration*, in THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 1154, 1165 (Peter Muchlinski, Federico Ortino, & Christoph Schreuer eds., 2008).

⁶² As amended by the Lisbon Treaty (amending the Treaty on European Union and the Treaty establishing the European Community), 2007 O.J. (C 306) 1. See Rome Statute of the International Criminal Court, July 17, 1998, 2187 U.N.T.S. 90

⁶³ Barton Legum, *The Introduction of an Appellate Mechanism: the U.S. Trade Act of 2002*, in ANNULMENT OF ICSID AWARDS 289, 296 (E. Gaillard & Y. Banifatemi eds., 2004).

⁶⁴ See Stone Sweet & Mathews, *supra* note 4, at 112-59.

⁶⁵ Due to space limitations, I ignore many important legal and political aspects of the six awards that have so far been issued. Although the Argentina awards are now the subject of scholarly commentary and controversy, I will not be able to engage these debates directly here. Compare Jose Alvarez & Katherine Khamsi, *The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime*, in YEARBOOK ON INTERNATIONAL INVESTMENT LAW & POLICY (forthcoming 2009) (arguing that proportionality/balancing is inappropriate to investor-State arbitrations) with William W. Burke-White & Andreas von Staden, *Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties*, 48 VA. J. INT’L L. 307 (2007) (proposing that arbitral tribunals should embrace a “margin of appreciation” approach developed by the ECHR). The Burke-White and von Staden article is insufficiently informed by proportionality analysis, failing to consider the fact that margin of appreciation (the discretion granted to a defendant state by a court) is not a stand-alone doctrine, but is instead a product of rigorous, prior scrutiny of necessity (least-restrictive means testing and balancing).

First, of the 123 cases now pending at ICSID, 33 are against Argentina. The total amount of the claims is not known, but estimates range from 8 to 80 billion dollars. Argentina will likely plead the “necessity defense” in all of them. Second, there is a growing perception that ICSID is in the throes of a legitimacy crisis, not least as a number of States—especially in Latin America—are reevaluating their membership in the organization, and the legitimacy of the investor-State regime as a whole.⁶⁶ Including the Argentina cases, Latin American States are defendants in 55 (45%) of all pending cases. Third, the global economy is today in deep crisis. Governments, of States rich and poor, are preparing a wide range of measures thought to be “necessary” to deal with the crisis. Major regulatory reform will inevitably put stress on the BIT-ICSID system, and could very well lead to more cases being brought against advanced-industrial States of the OECD. In any event, it is likely that the Argentine strategy—pleading the necessity defense—will become routine. Put bluntly, if ICSID does not develop a coherent framework for dealing with these cases, the system could well collapse. Yet it must do so in the absence of systemic hierarchy.

Virtually all of the Argentine cases are based on the same facts, which can be briefly summarized. After throwing off an oppressive military dictatorship (1973-85), Argentina sought both to democratize and to build a more market-oriented economy. In the early 1990s, it embraced the BIT regime, ratified the ICSID Convention, and began privatizing its extensive portfolio of State-run companies and utilities. By 1994, 90% of these holdings had been successfully privatized, virtually all of it with foreign participation. Argentina was able to attract foreign direct investment by, among other reforms, pegging its currency to the dollar, and promising that capital could move freely across borders. In addition, the various privatization laws and decrees gave investors the right to participate in decisions that would affect revenue, such as the fixing of utility rates, and the provision of certain services.

During the 1999-2002 period Argentina experienced an economic meltdown of cataclysmic proportions, precipitated by an exploding budget deficit, a balance of payments crisis, and mounting foreign debt. In 2001, Argentina began taking measures to meet the crisis, including: deep budget cuts; renegotiation of foreign debt (which did not stave off default); successive devaluations of the currency, which eventually ended in allowing the Peso to float on the markets; draconian limits on withdrawals from bank accounts, and “Pesification,” the forced conversion of dollar deposits into pesos. December 2001 saw rioting in the streets, a run on the banks; hyper-inflation; and political turmoil (five presidents were appointed in a ten-day period beginning on December 20, 2001), including threats of a military coup. By the end of 2002, one-quarter of all urban workers were unemployed, and a majority of the population lived under the official poverty line. It would probably be impossible to unravel the precise causal relationships that connect these factors: (1) the onset and deepening of the economic crisis; (2) mounting political instability, and (3) the increasingly desperate steps the Argentine State adopted to regain control. Each of these processes fed into the other two, leading the situation to spiral out of control.

What is indisputable is that Argentina’s response to the crisis destroyed the regulatory environment on which foreign investors had relied *ex ante*. Most important,

⁶⁶ See William Burke-White, *The Argentina Financial Crisis: State Liability under BITs and the Legitimacy of the ICSID System*, 3 ASIAN J. WTO & INT’L HEALTH L. & POL’Y 199 (2008).

Argentina reneged on key promises, among which: to maintain a fixed rate for the peso; to negotiate rate changes with investors; and to permit capital—profits—to be exported. Investors turned to ICSID claiming, among other things, that the Argentina has violated the FET standard. To date,⁶⁷ ICSID tribunals have issued five awards on such claims—*CMS* (May 2005), *LG&E* (October 2006, July 2007), *Enron* (May 2007), *Sempra* (September 2007), and *Continental Casualty* (September 2008)—ordering Argentina to pay more than \$600 million in damages, on original requests totaling more than \$1.8 billion. In addition, an Annulment Committee (September 2007) rendered a sixth ruling, pursuant to the *CMS* award; this ruling pointedly noted serious deficiencies, “errors in law,” in the reasoning of the *CMS* tribunal, some of which are relevant to this analysis. In these cases, for the first time ever, a State pleaded the “necessity” defense, a version of which is available in most BITs.⁶⁸ Article XI of the U.S.-Argentina BIT states: “This Treaty shall not preclude the application by either party of measures-necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.”

State measures that meet the requirements laid down in Article XI are not unlawful under the BIT, even if such measures would breach rights provided to investors in other parts of the Treaty, such as the FET standard (Article II of the U.S.-Argentina BIT). Proportionality analysis appears to be tailored made for application to Article XI of the U.S.-Argentina BIT, as anyone versed in proportionality would immediately recognize. As a matter of comparative law, the notion of “public order” is a broad one, normally encompassing any policy concern rising to some asserted threshold of importance. It would seem impossible to argue that the Argentine crisis would not qualify as touching upon “public order,” even under the narrowest of criteria. Standard proportionality analysis would then begin with some version of *suitability* analysis, involving a basic means-end, or nexus, test. Does the Argentina economic crisis fall within the coverage of Article XI; and were the State measures under review rationally connected to their declared purpose, namely, to confront the crisis in order to maintain public order? If “yes,” the analyst would move to the *necessity* phase: the deployment of a least-restrictive means test. Here is where the real work would normally take place. Did Argentina take measures that infringed more on investors’ rights than was necessary for the State to achieve its purposes? In a final phase of analysis, it still might be possible for the investor to prevail, even if State measures had survived the necessity test. At the balancing (*stricto sensu*) stage, arbitrators could find that the measures, though narrowly-tailored, nonetheless went too far, curtailing investors’ right too much, under the BIT.

International courts rarely deploy proportionality, step-by-step, as systematically as, say, the German and Israeli courts do. The ECtHR prefers a broader balancing approach, which it use, among other things, to define the scope of the State’s discretion

⁶⁷ See *supra* note 2.

⁶⁸ The UK-Argentina BIT does not contain a necessity clause. In March 2008, an unpublished ICC award came to light when Argentina applied for the award’s annulment in a U.S. federal district court. Papers filed reveal that a three-member ICC tribunal awarded British Gas, a UK company, more than \$185 million for breaches of the BIT. Argentina had pleaded necessity before the ICC, arguing that the defense was now an implicit part of all BITs. INVESTMENT TREATY NEWS (Apr. 1, 2008), http://www.iisd.org/pdf/2008/itn_april1_2008.pdf.

(which the ECtHR calls a “margin of appreciation”⁶⁹). In contrast, the ECJ and the WTO Appellate Body (AB) deploy relatively robust versions of necessity analysis when they adjudicate derogations to trading rules (under Article 30 of the Treaty of Rome⁷⁰ and Article XX of GATT,⁷¹ respectively). The ECJ and the WTO AB will typically rule against a State pleading derogations if they can find one (or preferably several) alternatives that were both less restrictive on trade, and reasonably available to policymakers. Modes of reasoning which Germans constitutional lawyers would associate more with balancing in the strict sense are often incorporated into necessity analysis. ICSID arbitrators would have been aware of these practices, not least, as templates for building their own frameworks for dealing with provisions such as Article XI.

Strikingly, in the first four awards rendered (on privatized gas concessions), ICSID tribunals did not embrace proportionality. In *CMS*, *Enron*, and *Sempra*, tribunals found that Argentina had breached the FET standard, while rejecting Argentina’s necessity pleadings. The tribunals all but refused to treat Article XI of the BIT as if it were an autonomous norm or source of law. Instead, they absorbed it into the customary international law defense of necessity, as expressed by Article 25 of the 2001 *Draft Articles on the Responsibility of States for Internationally Wrongful Acts* (International Law Commission (ILC)). Article 25 reads, *inter alia*:

1. Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act:
 - (a) is the only way for the State to safeguard an essential interest against a grave and imminent peril; and
 - (b) does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole ...⁷²

In effect, the *CMS*, *Enron*, and *Sempra* tribunals interpreted the “only means” requirement under Article 25 as fatal to the necessity plea under Article XI, if *any other means* were available to Argentina. Since the record showed that economists and other experts deployed by the parties disagreed on what mix of measures Argentina could or should have taken, the means chosen could not have been the “only” means. Further, in *dicta*, the tribunals suggested that no domestic economic crisis, of whatever magnitude, would qualify as a serious enough “peril” to fall under the necessity doctrine.

The *LG&E* tribunal also found breaches of the FET standard, but it analyzed necessity under Article XI (BIT) and Article 25 (ILC) separately, accepting the plea under both headings. The arbitrators referred to proportionality, but only in a sentence, and in the negative:

With respect to the power of the State to adopt its policies, it can generally be said that the State has the right to adopt measures having a social or general welfare purpose. In such a case, the measure must be accepted without any

⁶⁹ See *Handyside v. the United Kingdom*, 24 Eur. Ct. H.R. (ser. A) at 23 (1976).

⁷⁰ Treaty Establishing the European Community art. 30, Nov. 10, 1997, 1997 O.J. (C 340) 3.

⁷¹ General Agreement on Tariffs and Trade art. XX, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194.

⁷² Int’l Law Comm’n, *Report of the International Law Commission: Draft Articles on the Responsibility of States for Internationally Wrongful Acts*, U.N. Doc. A/56/10 (2001).

imposition of liability, except in cases where the State's action is obviously disproportionate to the need being addressed.⁷³

The award reveals no indication that the tribunal engaged in serious proportionality analysis of the Argentina response to the crisis. It excused Argentina of liability, but only for a specific "crisis" period (December 2001-April 2003). The *LG&E* tribunal level of assessed damages (\$57.4 million) was far below the compensation ordered by tribunals in the other cases.

In response, Argentina requested the establishment of annulment committees to quash the awards. To date, only the *CMS* Annulment Committee has produced a ruling. Clearly, ICSID authorities took appointment to the *CMS* Committee very seriously, selecting two members of the International Court of Justice, including the President of that Court, and the President of the ILC. The Committee stressed that it did not have the authority to act as an appellate court; in particular, it could not quash an award for having been based on "errors in law," no matter how serious. It then went on to detail what it called the "manifest" errors of interpretation made by the *CMS* tribunal, the most important of which was the conflation of Article XI of the BIT with customary international law. The *CMS* tribunal should have analyzed the pleadings under the two norms separately, as they are meant to function differently. The customary international law of necessity makes available to a State a defense for a breach of international law, once a breach has been found. In contrast, a plea under Article XI of the BIT, if accepted, precludes a finding of breach of the BIT in the first place. In extraordinary *dicta*, the Committee went on to state:

[The] errors made by the Tribunal could have had a decisive impact on the operative part of the Award. . . . In fact, it did not examine whether the conditions laid down by Article XI were fulfilled and whether, as a consequence, the measures taken by Argentina were capable of constituting, even *prima facie*, a breach of the BIT. If the Committee was acting as a court of appeal, it would have to reconsider the Award on this ground. . . . The Committee recalls, once more, that it has only a limited jurisdiction under Article 52 of the ICSID Convention. In the circumstances, the Committee cannot simply substitute its own view of the law and its own appreciation of the facts for those of the Tribunal.⁷⁴

The Committee's award is not formally binding on tribunals, or on future annulment committees but, given the status of its members and the quality of the reasoning, it will surely exert persuasive authority. If tribunals are more likely to treat the necessity clauses of BITs as *lex specialis*, detached from customary law, they are more likely to take the "public order" exception more seriously, to the benefit of defendant States. In the fifth case, *Continental Casualty v. Argentina* (September 2008), this is exactly what happened. Following the methodology traced by the *CMS* Annulment Committee, the *Continental Casualty* tribunal accepted Argentina's necessity

⁷³ *LG&E Energy Corp. LG&E Capital Corp. LG&E International Inc. v. Argentine Republic*, *supra* note 2, para. 195.

⁷⁴ *LG&E Energy Corp. LG&E Capital Corp. LG&E International Inc. v. Argentine Republic*, *supra* note 2, at paras. 135-36.

plea under Article XI of the BIT, relegating customary international law to virtual irrelevance.

The case involves a provider of employment compensation insurance in Argentina, Continental Casualty, which also maintained a portfolio of low-risk capital investments in Argentine financial institutions. Much of the value of this portfolio was lost with the *Pesification* of formerly dollar-denominated bank deposits, restrictions on capital flows, and the default and rescheduling of payments on certain debt instruments held by the company. It asked for \$114 million in compensation. The Tribunal found a breach of the FTE on only one relatively minor claim, awarding \$2.8 million plus interest. For all the other claims, the Tribunal accepted Argentina's plea of necessity under Article XI of the BIT.

For our purposes, what is important is that the Tribunal adopted a mature form of proportionality analysis, the version developed by the GATT panels and the AB for dealing with derogations to the GATT permitted under Article XX of that Treaty.⁷⁵ The *Continental Casualty* Tribunal's analysis of Article XI of the BIT is a rich piece of jurisprudence, far more sophisticated than the awards produced in the four previous cases. Here I only outline the main features of the Tribunal's approach and its findings.

The Tribunal began with the threshold issue: Was Article XI applicable to the dispute? Most important, the Tribunal held that Argentina's economic crisis fell within the coverage of Article XI, which permits State measures designed to maintain "public order" and to protect "essential security interests." After adopting a broad conception of the notion of public order found, notably, in French law, it ruled that:

[A]ctions properly necessary by the central government to preserve or to restore civil peace and the normal life of society (especially of a democratic society such that of Argentina), to prevent and repress illegal actions and disturbances that may infringe such civil peace and potentially threaten the legal order, even when due to significant economic and social difficulties, and therefore to cope with and aim at removing these difficulties, do fall within the application under Art. XI.

It also held that the Argentina fact context shows that "a severe economic crisis may ... qualify under Article XI as affecting an essential security interest."⁷⁶ The Tribunal then recognized, ECtHR-style, that the State possessed, *ex ante*, "a significant margin of appreciation"⁷⁷ in the determination of how to meet the crisis, thus setting the stage for necessity analysis.

The Tribunal—whose President, Giorgio Sacerdoti, had served on the AB of the WTO—adopted for itself the standards and methodology used in the WTO to adjudicate the necessity plea under Article XX of the GATT. Quoting from a classic case, *Korea-Beef*, the arbitrators asserted that "it is well-established" that:

[T]he term "necessary" refers . . . 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

⁷⁵ See Stone Sweet & Mathews, *supra* note 4, at 152-59.

⁷⁶ *Id.* para. 178.

⁷⁷ *Id.* para. 181.

of “indispensable” than to the opposite pole of simply “making a contribution to.”⁷⁸

Turning to the analysis of necessity, the Tribunal quoted extensively from what is today the leading WTO case, *EC-Tyres*, including this passage:

The necessity of a measure should be determined through “a process of weighing and balancing of factors” which usually includes the assessment of the following three factors: the relative importance of interests or values furthered by the challenged measures, the contribution of the measure to the realization of the ends pursued by it and the restrictive impact of the measure on international commerce.⁷⁹

The Tribunal then dutifully assessed the State measures under review with regard to a long list of alternatives that the plaintiff company argued were as effective, were reasonably available, and thus should have been taken. With one minor exception, the Tribunal rejected plaintiff’s arguments, finding that Article XI indeed covered Argentina’s measures. ICSID, which publishes awards upon the consent of both parties, did not release the *Continental Casualty* award, though Argentina did so. In January 2009, Continental Casualty asked that an Annulment Committee be constituted, a process currently under way.

V. ASSESSMENT AND CONCLUSION

Assuming that the positions taken by the ICSID tribunals in *CMS*, *Enron*, and *Sempra* have now been destroyed, one might well ask why they decided as they did. One can speculate.⁸⁰ First, it may be that these tribunals saw their central mission as the protection of investors’ rights, which is the purpose, after all, of the BIT system. Nonetheless, from the perspective of proportionality, it seems suicidal for arbitrators to proceed in this way—with a heavy thumb pressed permanently down on the investors’ side of the scales in cases with very high political stakes. Second, a necessity clause such as that contained in Article XI, had not previously been pleaded before an ICSID panel. The arbitrators could rely on an existing case law of other international courts and arbitral tribunals regarding the necessity defense under customary international law, but they would have been alone and exposed treating Article XI as a separate defense. A third consideration follows from the first two. To adopt proportionality-style necessity analysis would place arbitrators in the position of the balancing judge as perhaps something quite different than arbitrators traditionally conceived. This prospect, too, might have made them uncomfortable.

⁷⁸ Korea—Measures Affecting Imports of Fresh, Hilled and Frozen Beef AB-2000-8, art. 161 *reprinted in LG&E Energy Corp. LG&E Capital Corp. LG&E International Inc. v. Argentine Republic*, *supra* note 2, para. 194.

⁷⁹*Id.* para. 195. This formulation incorporates, into necessity analysis, considerations typically associated with balancing (proportionality in the strict sense).

⁸⁰ It should be noted at the outset that one arbitrator, Francisco Orrego Vicuña (Chilean), served as president of each of these tribunals, which shared another member. One might legitimately ask how likely it is that he will be appointed to future cases.

Yet, through the *Continental Casualty* decision, proportionality has now made a grand entrance, and this raises some underlying theoretical issues. Jud Mathews and I have sought to explain the emergence and diffusion of the proportionality framework as a best-practice standard that judges use to deal with a certain kind of conflict, now ubiquitous.⁸¹ We did so without reference to any system of international arbitration. Proportionality analysis, we argued, “fits” the normative structure of “qualified rights,” in which States may take measures that would otherwise infringe such rights (or other entitlements), when necessary to achieve some legitimate public policy purpose. The necessity clause found in most BITs is an example of such a normative structure. We also claimed that third party dispute resolvers had good strategic reasons for adopting proportionality, and then showed that they had done so, in a wide range of contexts. They did so, not least, in order to deal with the most politically controversial disputes that they were likely to face. The future of proportionality within ICSID is a test of these claims, and ultimately, of the underlying theory. This future will also help to determine whether the second model of Investor-State arbitration described in this Article will prevail; I presume it will.

These points made, I think it would wise for ICSID tribunals to embrace the proportionality framework (but not in order to vindicate my theory). The necessity defense is likely to become a normal feature of Invest-State arbitration; and proportionality offers to arbitrators the best available doctrinal framework with which to meet the present challenges to the BIT-ICSID system.

⁸¹ Stone Sweet & Mathews, *supra* note 4.