

International obligations of states going through an economic crisis

Post Doctorate Proposal- Suha Ballan

Can an economic crisis satisfy the conditions for exempting state liabilities under international law, and how should states shape their international obligations in a way that allows them to take the necessary measures for managing an economic crisis without facing claims from foreign investors in international arbitration? This will be the main inquiry of my research, with particular focus on international investment law and the state of Israel as a case study, since Israel is still negotiating Bilateral Investment Treaties (BITs) with major capital exporting states.

In the era of global financial liquidity and mobilization of capital, states have less influence on their markets, and are more exposed to economic crises caused by external impacts. In such situations, states' regulatory agencies are expected to pursue immediate and effective measures in order to minimize the scope of the economic crisis and its damage. Yet, nationalizing a bank or changing state's contracts in vital sectors may fall short of a BIT obligation when such measures cause losses for a foreign investor. Hence, international obligations, in general, and investment treaties, in particular, may seem to impede such immediate measures, or may cause them to be much more costly.

The necessity doctrine in customary international law¹ and emergency clauses in BITs² (when they exist) are hardly applicable under a severe economic crisis, suggesting that only states and local investors should bear the costs of measures taken by states to recover from the crisis. Hence, foreign investors, while enjoying the benefits of prosperity in foreign markets, avoid costs when these markets fail. I suggest that the current global economic and financial order demands re-evaluating the allocation of costs by incorporating clauses in BITs that address economic crises and set a special compensating system for such cases.

¹ See discussion in Part B of this proposal.

² See discussion in Part C of this proposal.

A. An Overview: the Experience of Argentina and Other States:

Today, the global regime of international investment law is shaped by more than 2,800 bilateral investment treaties (BITs).³ These treaties set various standards of the protection and treatment of (foreign) investors. These treaties usually include standards, such as the protection against arbitrary and discriminatory measures, expropriation of property made in a discriminatory manner, not with due process, or not against compensation, and the standard for fair and equitable treatment. Finally, when an investor faces losses for measures taken by the host in violation of the treaty, then she can pursue a claim for damages in international arbitration as offered by the treaty, and hence avoid dealing with the national legal system in the host state.

In the years 1999-2000, Argentina passed through a severe economic crisis, causing serious disruptions in its citizens' daily life and in the supply of vital goods. An emergency law was legislated allowing the government to devalue the Peso, and eliminated the right to calculate tariffs in U.S. dollars.⁴ Later, Argentina faced dozens of claims, brought by foreign investors, who incurred huge losses caused directly by the measures taken by Argentina under the emergency law.⁵ Argentina lost most of these claims, and by the year 2008, it was ordered to pay a total sum of more than a billion dollar to these investors.⁶ Argentina claimed that the severe conditions of the economic crisis and the measures that followed fall under the necessity doctrine in customary international law,⁷ as well as the emergency clause in the relevant BIT. Had this defense claim been accepted,⁸ Argentina would have been exempted from liability or from

³UNCTAD, WORLD INVESTMENT REPORT 2012: TOWARDS NEW GENERATION OF INVESTMENT POLICIES (2012), 84.

⁴Law No. 25.561, January 6, 2002.

⁵Among these cases: *CMS v. Argentine Republic*, ICSID Case No. ARB/01/8; *Abaclat and Others v. Argentine Republic*, ICSID Case No. ARB/07/5; *BG Group Plc. v. The Republic of Argentina*, UNCITRAL; *Continental Casualty Company v. The Argentine Republic*, ICSID Case No. ARB/03/9; *El Paso Energy International Company v. The Argentine Republic*, ICSID Case No. ARB/03/15.

⁶The sum includes interest, and some cases were still pending, See: Luke E. Peterson, *Argentina by the numbers: where things stand with investment treaty claims arising out of the Argentine financial crisis*, IA REPORTER (Feb 1st, 2011), available at: http://www.iareporter.com/articles/20110201_9.

⁷See Article 25 of International Law Commission, *Draft Articles for the Responsibility of States for Internationally wrongful Acts*, YEARBOOK OF THE INTERNATIONAL LAW COMMISSION, 2001, vol. II (Part Two).

⁸Article XI in the Argentina-US 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."

paying compensations. Yet most of the arbitration tribunals in these cases decided that Argentina did not satisfy the conditions of either the necessity doctrine or the emergency clause.⁹

During the year 2013, Cypriot authorities nationalized one of the largest banks in Cyprus, as the bank had suffered losses of four billion Euros due to the Greek economic crisis and was under the threat of bankruptcy. Again, this measure led to one of the bank's shareholders making a claim of 820 Million Euro.¹⁰ If the suit proves to be successful, it may be followed by claims of foreign investors amounting to more than 1.5 Billion Euro,¹¹ hence repeating the experience of Argentina with investment treaty arbitration.

Finally, during the 90s, all major banks in the Czech Republic were facing financial liquidity problems and were under the threat of bankruptcy, which could naturally cause a severe economic crisis. One of these banks was owned by a foreign investor. The Czech authorities nationalized this bank and offered financial support for the other banks. An international arbitration tribunal decided that this conduct was in violation of the fair and equitable treatment.¹²

These cases show some of the possible collisions between international liabilities and states' regulatory discretion under economic crises: states' measures in extreme economic conditions may be considered to violate fair and equitable treatment by frustrating investors' legitimate expectations, may be considered as an expropriation, or may be discriminatory. All such conclusions are followed by an order to pay compensation, which may further burden the state. Of particular interest is the fact that there is almost a complete separation between the merits phase and the quantum of damage phase, which leads tribunals ruling that compensation should be made for the entire damage suffered by the investor, without any attempt to balance the allocation of costs between the state and investor.

⁹ For the application of the necessity doctrine and emergency clause in some of the cases, see: Jose Alvarez & Kathryn Khamsi, *Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime*, *THE YEARBOOK ON INTERNATIONAL INVESTMENT LAW AND POLICY* 379 (Karl Sauvant ed., 2008-2009).

¹⁰ *Marfin Investment Group v. The Republic of Cyprus*; See *THE FINANCIAL TIMES*, Greek Fund in Legal Move Against Cyprus (18.1.2013), available at <http://www.ft.com/intl/cms/s/0/6a859688-6197-11e2-82cd-00144feab49a.html#axzz2vIBYbg8u>.

¹¹ *Ibid.*

¹² *Saluka v. the Czech Republic*, UNCITRAL, partial award (March 17, 2006).

B. International Law and the Necessity Doctrine:

I will first present a historical preview of the development of the necessity doctrine and show that the development of international law has almost never allowed states to be exempt from international obligations because of an economic crisis, and hence the necessity doctrine has historically not been applied in the case of economic crises.¹³

I will also show how the conditions for the claim of necessity, as stated today in the ILC's Draft Articles for the Responsibility of States,¹⁴ are hardly applicable in the case of economic crises. More specifically, it is the provision that the challenged measure is the "only way for the State to safeguard an essential interest against a grave and imminent peril"¹⁵ that makes it almost impossible to satisfy due to the uncertainty embedded in the economy and in the behavior of markets.

C. International investment law regime and the exemption of states:

As the early development of the modern international investment law shows, one of the principal justifications for the preferential treatment of foreign investors is that these investors are not parties in the political constituency of the host state and hence are not able to participate in the political decision-making.¹⁶ Following this rationale, bilateral investment treaties are not aimed at exempting states from liability where an economic crisis erupts,¹⁷ and are designed to preserve the conditions in which the foreign investor had entered into to the state's market.

¹³ For an overview of the use of necessity in cases of economic crises, see Sara Hill, the "Necessity Defense" and the Emerging Arbitral Conflict in its Application to the U.S.-Argentina Bilateral Investment Treaty, 13 LAW & BUS. REV. AM. (2007), 547, 555-557.

¹⁴ International Law Commission, *Draft Articles for the Responsibility of States for Internationally wrongful Acts*, YEARBOOK OF THE INTERNATIONAL LAW COMMISSION, 2001, vol. II (Part Two).

¹⁵ Art. 25 of the ILC Draft Articles, *Ibid*, goes as follows: "1. Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act: (a) is the only way for the State to safeguard an essential interest against a grave and imminent peril; and (b) does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole. 2. In any case, necessity may not be invoked by a State as a ground for precluding wrongfulness if: (a) the international obligation in question excludes the possibility of invoking necessity; or (b) the State has contributed to the situation of necessity." For a discussion on the application of these conditions for an economic crisis in the context of international investment law, see Stephan W. Schill, International Investment Law and the Host State's Power to Handle Economic Crises – Comment on the ICSID Decision in *LG&E v. Argentina*, 24(3) J. OF INT'L ARB. (2007), 265.

¹⁶ See ECHR, *James & others v UK*, Judgment of 21 Feb 1986, §63. Also See: Rudolf Dolzer and Christoph Schreuer, THE PRINCIPLES OF INTERNATIONAL INVESTMENT LAW (1st edition 2008), 13.

¹⁷ See Alvarez & Khamsi, *supra* n. 9.

I will examine existing emergency clauses in bilateral investment treaties, when these are found, with a focus on Israel's bilateral investment treaties.¹⁸ I will show that most of these treaties do not include an emergency clause, and neither does Israel's 2003 Model BIT,¹⁹ and when they do, these do not satisfy the conditions of an economic crisis.

D. Developments in global economy and suggested adjustments:

The application of the necessity defense in the context of investment treaty arbitration was discussed widely in literature.²⁰ However, this discussion in the literature the issue is isolated from the current global economic order and the need to re-evaluate the allocation of costs in the cases of economic crises. In this proposal, it is suggested that developments in the global economy call for re-examining the regime for foreign investors under conditions of an economic crisis in the host state: first, the weakened control of states on their markets exposes them to external factors that may cause an economic crisis inside the state. Hence, it is not only the state's conduct and regulations that may cause an economic crisis, which leads to re-evaluating the costs of an economic crisis, in general, and as pertains to foreign investors, in particular.

Second, "foreign investors" are no longer outsiders vis-à-vis state's decision making: foreign investors can lobby for their interest in the parliament or negotiate with high-level state officials. In addition, corporations that are incorporated outside the state can be owned by nationals of the host state, and still the treaty allows a claim to be filed in an international tribunal. As a result, the allocation of costs between the state and foreign investors should be re-evaluated: the research will suggest adjusting the evaluation of compensations, when a state is found liable for losses caused by measures taken under an economic condition. Currently, fair market value is the most common method for evaluating the compensation the state should pay to the investor. Market value burdens only the state with the costs of the economic crisis, while theoretically the investors eventually suffer no losses. Treaties should set different compensation methods in the context of an economic crisis that offer fair allocation of costs between the state and the investor.

¹⁸According to the Israeli Ministry of Finance website, Israel has concluded more than 30 BITs: available at: <http://www.financeisrael.mof.gov.il/FinanceIsrael/Pages/en/EconomicData/InternationalAgreements.aspx>.

¹⁹Model BIT 2003, Available at <http://www.financeisrael.mof.gov.il/FinanceIsrael/Docs/En/InternationalAgreements/IPa.pdf>

²⁰ See for example Supra note 9, 13, and Schill at *supra* n. 15. Also See August Reinisch, Necessity in International Investment Arbitration - An Unnecessary Split of Opinions in Recent ICSID Cases - Comments on CMS v. Argentina and LG&E v. Argentina, 8 J. WORLD INVESTMENT & TRADE 191 (2007).

Curriculum vita

NAME: **Suha Jubran-Ballan**

Academic Studies:

2009	PhD student at Tel Aviv University, Faculty of Law (estimated date of accomplishment: July 2014).
2005	LLM degree at Tel Aviv University with distinction. Final Thesis grade: 94
1999	LLB degree at Haifa University and a division in philosophical studies, with distinction (average: 86).
1994-95	Psychology studies in Haifa University

Academic Activities:

2012-2014	Member of the forum for Law, Corporations and the transnational Sphere in Tel-Aviv University
2010	Academic Administrator of the course “Theoretical Approaches to Law”
2010	Initiation of a legal theory workshop for post graduate students.
1998	Assistant at Haifa University, the Faculty of Law.

Workshops and Conferences:

June 2012	<u>The Exercise of Public Authority by Investment Treaty Arbitration: An Institutional Perspective</u> <i>in</i> The Exercise of Public Authority by International Tribunals Workshop, Co-organized by Zvi Meitar Center for Advanced Legal Studies & The Max Planck Institute for comparative public law and international law
January 2013	<u>Investment Treaty Arbitration: An Institutional Perspective</u> in the Harvard IGLP 2013 Workshop
April 2013	<u>Investment Treaty Arbitration: An Empirical Study on the Behavior of Institutions</u> <i>in</i> Concluding Event: Research Grants on the Law, the Transnational Sphere and human rights.
November 2013	<u>Mapping Investment Treaty Arbitrations: Repeated Arbitrators</u> <i>in</i> Law Doctoral Students Conference in Israel.

Scholarships and Research Grants:

2011-2014	Israeli Counsel for Higher Education Fellowship for Distinguished Doctoral Students from Minority Groups
2013	The Minerva Center for Human Rights research grant for the studies of Law, Corporations and the Transnational Sphere
2012	The Minerva Center for Human Rights research grant for the studies of Law, Corporations and the Transnational Sphere
2010	Zvi-Metar Affiliate
2004	Cegla Fellowship for LLM Students

Professional Background

July 2000- June 2004	Lawyer at “Flavian law-Firm” in Haifa.
July 1999- March 2000:	Trainee at Haifa District court assisting Judge Sh. Wasserkrug.
March 1999- June 1999:	Trainee at Haifa magistrate’s court assisting Judge I. Shelou.
October 1997- February 1998:	“Guri, Sobol and Shperber- Law Firm” in Haifa as an assisting student.

Social Activities:

1997-98	Volunteered in "one-to-one" project at Haifa University, in which students in advanced years support first-year-students
1994-1998	A member in the "Bruno Kraiski Youth Peace Forum" and participating in seminars held in Austria, Jordan, Israel and the Palestinian Territories.
1993	Participating in the Foreign ministry youth seminar for exposing youngsters to the diplomatic field.