ECONOMIC CRISES AND FOREIGN INVESTORS: BETWEEN NECESSITY AND REPARATION

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I. INTRODUCTION

Managing investment claims during an economic crisis is a challenging topic for states. While most states today are signatory to

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dozens of investment treaties, they are also more susceptible, due to the liquidation of capital, to economic crises triggered or intensified by external variables. Indeed, economic crises in recent years are more frequent as states are unable to fully control their economy and are now no less likely than natural disasters or wars.

[1] Nevertheless, states are more likely to invest effort in shaping mechanisms for compensating victims of natural disasters than mechanisms for managing investor claims during an economic crisis.

Deriving from available state-based models for the reparation and compensation of victims of mass disasters,[2] this paper shows how setting investor-state arbitration as the default mechanism for dispute settlement is the least appropriate solution when considering recovery, cost-allocation, and efficiency. Instead, this paper suggests that investor-state arbitration, largely focused around the necessity defense, should be a last-resort method for compensating foreign investors.

The argument in this paper is that the remedies for violation of an investment treaty, based on a private law analogy, are the least desirable remedies for damages caused to foreign investors during economic crises. Accordingly, we should rather apply the existing remedies in public law for compensating victims of major disasters, partially or fully, to manage the costs laid on foreign investors due to state measures taken to overcome an economic crisis.

Within the literature concerning reparations for national crises, we find several reparation models provided by states for mass injuries such as liability rules, private risk insurance, mandatory risk insurance, a compensation fund and ad hoc tribunals.[3] Examining those regulations shows that investment treaty arbitration shares the advantages and the disadvantages of liability rules to a considerable extent. This Literature suggests, however, that liability rules are the least preferable remedy, due to their high costs and duration, as well as the lack of an upper limit for the costs that a state can bear. Hence, learning from the experience of states with managed crises, whether natural or man-made, we examine

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1 Since the beginning of the 21st Century, more than five economic crises have occurred in different states: Argentina's debt crisis (1999-2000), the U.S.'s dot com crisis (2001), Iceland's financial crisis (2008), the global financial crisis starting in the U.S. (2007), the European debt crisis (2010), and the Russian economic crisis (2014).

2 *See generally* Michael Faure, *Financial Compensation for Victims of Catastrophes: A Law and Economics Perspective*, 29 LAW & POL'Y 339 (2007); FINANCIAL COMPENSATION FOR VICTIMS OF CATASTROPHES: A COMPARATIVE LEGAL APPROACH (Michael Faure & Ton Hartlief eds., 2006).

3 *See infra* Part V.

the applicability of the aforementioned solutions in the context of foreign investors in the era of bilateral investment treaties (BITs).

After a short introduction and background, Part II analyzes investment treaty awards rendered after the 1999-2001 economic crisis in Argentina. In this context, applying the necessity defense to economic crises was challenging and the evaluation of damages was largely influenced by the methods developed in private law or contract law. This paper then proceeds, in Part III, to address the difficulties in applying the necessity defense for economic crises and for the evaluation of damage.[4] First, that the necessity defense as acknowledged in customary international law prescribes an all or nothing approach, with little room for a more balanced cost allocation.[5] Second, in deciding the remedies, investment treaty arbitration tribunals have mainly followed the methods available in customary international law, which are based on private law, and disregarded the methods for reparation that are available in public law. In Part IV, we examine four different schemes for compensating victims of mass disaster that were developed in the national legal systems, which combines both public and private law remedies: liability rules, private risk insurance, mandatory risk insurance, and a compensation fund. We present the advantages and disadvantages of those methods and then examine their applicability to investor-state disputes. Finally, in Part V, we conclude that unless those methods are internalized in the treaties, states should avoid investor-state arbitration when an economic crisis erupts and provide an alternative method of reparation for foreign investors.

II. THE NECESSITY DEFENSE IN INTERNATIONAL LAW

In the era of global financial liquidity and mobilization of capital, states have less and less influence on their markets, and are more exposed to economic crises caused by external impacts.[6] In such situations, a

4 For details on the necessity defense, see Int'l Law Comm'n, Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries, art. 25, U.N. Doc. A/56/10, at 28 [hereinafter ILC DASR].

5 An exception may be found in the ILC DASR. Article 27 allows tribunals to order compensation for wrongful acts even if those acts satisfy the necessity defense. *See* discussion *infra* note 56 and accompanying text.

6 *See generally* INT'L MONETARY FUND, CAPITAL FLOWS—REVIEW OF EXPERIENCE WITH THE INSTITUTIONAL VIEW (2016), https://www.imf.org/external/np/pp/eng/2016/110416a.pdf [hereinafter INT'L MONETARY FUND]; Joseph E. Stiglitz, Lessons from the Financial Crisis and their Implications for Global Economic Policy 7-8 (2018) (unpublished manuscript), https://www8.gsb.columbia.edu/faculty/jstiglitz/sites/jstiglitz/files/Lessons%20from%20the%20F

state's regulatory agencies are expected to pursue immediate and effective measures in order to minimize the scope of the economic crisis and its costs. Yet, nationalizing a bank or revising a contract in vital sectors may contradict international obligations arising from investment agreements when such measures cause losses to foreign investors.[7] Hence, international obligations, in general, and investment agreements, in particular, may impede such immediate measures, or may cause these measures to be more expensive than anticipated.

In the absence of a specific treaty provision exempting states from liability, a state can only rely on the necessity defense in customary international law, which precludes liability for international wrongful acts in cases of necessity.[8] The necessity defense is long recognized in customary international law and invoked by states in various contexts as a defense for precluding wrongful actions not in conformity with certain international obligations.[9] We focus on the necessity defense as articulated by the International Law Commission (ILC), which is, for our needs, proximate enough to customary international law.[10] Article 25 of the International Law Commission on the Responsibility of States for International Wrongful Acts (ILC DASR) articulates the conditions for invoking a necessity defense:

> 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

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inancial%20Crisis.pdf; Joseph E. Stiglitz, *Reforming the Global Economic Architecture: Lessons from Recent Crises*, 54 J. OF FIN. 1508, 1509-10 (1999).

7 *See, e.g.*, Saluka Inv. BV v. Czech Rep., Neth-Czech, Partial Award, (Perm. Ct. Arb. 2006).

8 *See* ILC DASR, *supra* note 4. On the relation between a treaty exception and the exception of necessity in customary international law, see Jürgen Kurtz, *Adjudging the Exceptional at International Investment Law: Security, Public Order and Financial Crisis*, 59 INT'L & COMP. L.Q. 324, 325-28 (2010).

9 *See* ILC DASR, *supra* note 4.

10 *See generally id*.

(b) the State has contributed to the situation of necessity.[11]

As the ILC DASR commentary explains, those conditions strictly limit the use of necessity to prevent states from abusing this defense.[12] Accordingly, the necessity defense requires the state to satisfy these four conditions cumulatively for the claim to be accepted.[13]

According to Article 25(1)(a), the first condition for a state to satisfy is that the contested measure is "the only way for the states to safeguard an essential interest against a grave and imminent peril."[14] The ILC report explicitly states that safeguarding an essential interest is not only confined to the existence of the state, but also to a wide variety of interests such as safeguarding the economy or ecology.[15] Accordingly, a severe economic crisis risking the economic survival of the state or the maintenance of the state's essential services may indeed satisfy as a grave peril for an essential interest.[16] A state that is able to show that such threat is imminent, a considerable challenge by itself, has yet to prove that violating an international obligation is the only way to safeguard that interest. Determining whether a state measure has indeed satisfied this condition entails professional economic expertise, often raising alternative measures and hypothetical occurrences.[17] Due to the high uncertainty involved, determining whether this condition is satisfied cannot be solely based on professional and scientific grounds, but also involves certain policy considerations. The ILC was aware of this issue and, in its commentary, referred to the judgment of the International Court of Justice (ICJ) in *Gabčíkovo-Nagymaros Project* stating that, while a measure of uncertainty about the future may exist, it does not "necessarily disqualify a State from invoking necessity, if the peril is clearly established on the basis of the evidence reasonably available at the time."[18] Such a statement, though helpful, does not clear all doubt about the proper application of this condition for the necessity of measures to stabilize a deteriorating economy.

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11 ILC DASR, *supra* note 4.

12 *Id.* at 83.

13 *Id.* at 80; *see also* Gabčíkovo-Nagymaros Project (Hung. v. Slovk.), Judgement, 1997 I.C.J. Rep. 7, ¶¶ 51–52 (Sept. 25).

14 ILC DASR, *supra* note 4.

15 *See id.* at 83. For the statement of Roberto Ago, member of the ILC, in the United Nations, see Int'l Law Comm'n, Rep. on Circumstances Precluding Wrongfulness, U.N. Doc. A/CN.4/SER.A, at 22-23 (1980). *See also* LG&E Energy Corp. v. Argentine Rep., ICSID Case No. ARB/02/1, Decision on Liability, ¶ 251 (Oct. 3, 2006).

16 *See LG&E Energy Corp.*, ICSID Case No. ARB/02/1, ¶¶ 237-38.

17 *See* Kurtz, *supra* note 8, at 342.

18 *See* ILC DASR, *supra* note 4, at 83.

The application of the second and third conditions does not raise significant difficulties in the context of an economic crisis. First, it is unlikely—though not impossible—that measures taken by a state to recover from an economic crisis would undermine the essential interests of another state or the international community. Considering the interlinked and intensive economic relations between states, it is rather the economic crisis that may undermine the economic stability of other states, and so it is a shared interest of the international community to contain an economic crisis.[19] As to the third condition, investment agreements do not usually include an explicit exclusion of necessity, while an implicit exclusion is not reasonable due to the nature of the treaties.[20] It is likely that if a treatment of an investor amounted to a breach of other international obligations that exclude necessity, then that treatment went way beyond what was necessary to recover from an economic crisis and that necessity would not be satisfied anyway.

The fourth condition, requiring that the state did not contribute to the situation of necessity, has a clear and simple rationale: a state cannot benefit from a situation it could have avoided.[21] The ILC DASR explains that a state contribution should be substantial and not incidental.[22] Applying such a condition to an economic crisis, however, narrows, to a large extent, the possibility of accepting the defense. Economic crises, except for those that are caused by a natural disaster, are almost never sudden or unexpected and are usually accompanied by the economic policy of the state whether reflected in its actions or its defaults. As such, it is rare that we identify the reasons of an economic crisis as fully resulting from external factors over which a state has no control.[23]

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19 Joseph E. Stiglitz, *The Current Economic Crisis and Lessons for Economic Theory*, 35 E. ECON. J. 281, 282 (2009).

20 The ILC suggest that some international obligations may implicitly exclude necessity as they are intended to apply in abnormal situations of peril and engage in essential interests of the state concerned. *See* ILC DASR, *supra* note 4, at 84.

21 *See* The Gabcíkovo-Nagymaros Project (Hung./Slovk.), Judgment, 1997 I.C.J. Rep. 7, ¶ 57 (Sept. 25).

22 ILC DASR, *supra* note 4, at 84.

23 Considering that both external and internal factors contribute to the creation of an economic crisis, it is not surprising that the tribunals that had to determine this question in the context of the Argentinian economic crisis reached different conclusions. While all tribunals acknowledged that both internal and external factors played a role, the tribunals in *Enron Co. Ponderosa Assets L.P.* and *El Paso Energy Int'l Co.* for example, concluded that Argentina contributed to the economic crisis and was not exempt from liability. *See* Enron Co. Ponderosa Assets, L.P. v. Argentine Rep., ICSID Case No. ARB/01/3, Award, ¶¶ 311-12 (May 22, 2007); El Paso Energy Int'l Co. v. Argentina, ICSID Case No. ARB/03/15, Award, ¶¶ 649-670 (Oct. 31, 2011). However, two tribunals concluded to the contrary. *Cf.* LG&E Energy Corp. v. Argentine Rep., ICSID Case No.

In the following section, we examine how investment treaty tribunals in the Argentinian economic crisis applied the necessity defense in the context of an economic crisis. We also indicate the difficulties in applying the defense and the consequences of these decisions on the issue of damages.

A. The Application of the Necessity Defense in the Argentinian Cases

Between 1999 and 2001, Argentina had one of its severest economic crises. A combination of both external and internal factors in the late nineties triggered a financial crisis due to a high foreign debt deficit.[24] Dozens of claims were filed by foreign investors following the emergency measures taken by the government.[25] Those investors claimed that Argentina, through the measures it took to recover from the crisis, violated its investment treaty obligations such as expropriation of compensation, fair and equitable treatment, or preserving commitments it had taken with regards to an investment. Almost all tribunals found that Argentina's measures did indeed violate one or more of these obligations and turned to examine Argentina's plea for necessity, and Argentina was ordered to pay more than a billion dollars in accumulated damages. Those tribunals, however, took different approaches in examining the claim of necessity on which we elaborate in this section.[26]

Differences among the tribunals ruling on the Argentinian cases are found with regards to specific standards of the treaties that were breached, but also on the proper application of the necessity defense and an emergency clause in the Argentina-U.S. bilateral investment treaty.

ARB/02/1, Decision on Liability, ¶ 256 (Oct. 3, 2006); Continental Casualty Co. v. Argentine Rep., ICSID Case No. ARB/03/9, Award, ¶¶ 231-236 (Sept. 5, 2008).

24 *See* CHRISTINA DASEKING, ATISH GHOSH, TIMOTHY LANE & ALUN THOMAS, LESSONS FROM THE CRISIS IN ARGENTINA 2 (2004).

25 *See, e.g.*, *LG&E Energy Corp.,* ICSID Case No. ARB/02/1, ¶ 256*; Siemens* A.G. *v. Argentine Rep.*, ICSID Case No. ARB/02/8, Award, ¶ 99 (Jan. 17, 2007); *Enron Co. Ponderosa Assets, L.P.*, ICSID Case No. ARB/01/3, ¶¶ 41-46*; Sempra Energy Int'l v. Argentine Rep.*, ICSID Case No. ARB/02/16, Award, ¶ 355 (Sep. 28, 2007)*; BG Group Plc. v. Rep. of Argentina, Final Award,* ¶ 381 *(UNCITRAL Arb. Trib. Dec. 24, 2007)*; *Continental Casualty Co.*, ICSID Case No. ARB/03/9, ¶ 159; *National Grid Plc. v. Argentine Rep.,* Award, ¶ 59-60 (UNCITRAL *Arb. Trib. Nov. 3, 2008); El Paso Energy Int'l Co.,* ICSID Case No. ARB/03/15, ¶ 49.

26 *See generally* Jose Alvarez & Kathryn Khamsi, *Argentine Crisis and Foreign Investors: A Glimpse Into the Heart of the Investment Regime,* 2009 Y.B. INT'L INV. L. POL'Y 379; Kurtz, *supra* note 8.

While the tribunals in *CMS*,[27] *Enron*,[28] *Sempra*,[29] *Total S.A.*,[30] *National Grid*,[31] *Impregilo*,[32] and *El Paso Energy*[33] denied Argentina's necessity defense for measures taken during the economic crisis, the tribunals in *LG&E*[34] and in *Continental Casualty*[35] determined that the conditions for claiming necessity were indeed satisfied, although only for a specific time period; the *LG&E* tribunal did not exempt Argentina from complying with its international obligations before and after that time period.[36] The following explains, in more detail, how those tribunals determined the application of the necessity defense. While we cannot bring here the ruling of all tribunals, we focus on the awards in the claims brought by *Enron* and *LG&E*, being both stemming from the measures taken to re-regulate the energy sector, while dismissed the necessity defense and the other accepted it.

1. *The Application of Article 25(a)(1): Whether a Wrongful Act was the Only Way to Safeguard an Essential Interest from Grave and Imminent Peril*

The tribunals examined whether a "grave imminent peril" did indeed threaten an essential interest of Argentina. The *Enron* tribunal decided that the independence or existence of the state was not compromised and the situation was still under control and could be handled under the constitutional arrangements in force.[37] The *LG&E* tribunal, however, decided that an essential interest of Argentina "faced an extremely serious threat to its existence, its political and economic survival, to the

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27 *See generally* CMS Gas Transmission Co. v. Rep. of Argentina, ICSID Case No. ARB/01/8, Award (May 12, 2005).

28 *Enron Co. Ponderosa Assets L.P.*, ICSID Case No. ARB/01/3, ¶ 391.

29 *Sempra Energy Int'l,* ICSID Case No. ARB/02/16, ¶ 355.

30 Total S.A. v. Argentine Rep., ICSID Case No. ARB/04/1, Decision on Liability, ¶ 485 (Dec. 27, 2010).

31 *Id.* ¶ 260.

32 Impregilo S.p.A v. Argentine Rep., ICSID Case No. ARB/07/17, Award, ¶ 359 (June 21, 2011).

33 El Paso Energy Int'l Co. v. Argentine Rep., ICSID Case No. ARB/03/15, Award, ¶ 752 (Oct. 31, 2011).

34 LG&E Energy Corp. v. Argentine Rep., ICSID Case No. ARB/02/1, Decision on Liability, ¶ 267 (Oct. 3, 2006).

35 Continental Casualty v. Argentine Rep., ICSID Case No. ARB/03/9, Award, ¶ 304 (Sept. 5, 2008).

36 *LG&E Energy Corp.*, ICSID Case No. ARB/02/1, ¶ 266.

37 Enron Co. Ponderosa Assets, L.P. v. Argentine Rep., ICSID Case No. ARB/01/3, Award, ¶¶ 306-7 (May 22, 2007).

possibility of maintaining its essential services in operation, and to the preservation of its internal peace."[38]

The tribunals also reached different conclusion with regards to the requirement that Argentina act in the only way available to safeguard an essential interest. The tribunal in *Enron* simply indicated that the experience of other states that had gone through an economic crisis showed that there was more than one way to act, and hence Argentina did not satisfy the requirement.[39] The *LG&E* tribunal determined that emergency measures were the only means to stabilize the economy based on the conclusion that "an across-the-board response was necessary," and such response should have addressed the tariff adjustment policy.[40] While the tribunal acknowledged that other means may have been possible, it determined that Argentina's actions satisfied the conditions of Article 25(a)(1).[41] It is notable in this regard that both tribunals avoided examining hypothetical scenarios with regards to what Argentina could have done; the *Enron* tribunal reached its conclusion without even examining the specific case of Argentina and its needs at that time and without showing that the experience of other states was indeed relevant. The *LG&E* tribunal only stated that the measures should have addressed the tariff adjustment policy, yet it did not show that the way this policy was addressed was indeed the only way. Moreover, the tribunals did not examine the substance of the expert witnesses brought before them by the parties, which did not seem to assist the tribunals as they were sharply divided on this matter.[42]

2. The Application of Article 25(b)(2): Whether Argentina Contributed to the State of Necessity

Tribunals do not seem to agree more on the issue of contribution to the situation of necessity. While expert opinions were also sharply divided on this matter, both tribunals avoided analysis in that regard and reached their conclusions through general observation hardly scratching the issue. The *Enron* tribunal stated that international institutions and Argentina itself agreed that both exogenous and indigenous factors caused the crisis and found that acknowledgement sufficient enough to conclude that Argentina's contribution was substantial enough that the

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38 *LG&E Energy Corp.*, ICSID Case No. ARB/02/1, ¶ 257.
39 *Enron Co. Ponderosa Assets, L.P.*, ICSID Case No. ARB/01/3, ¶ 308.
40 *LG&E Energy Corp.*, ICSID Case No. ARB/02/1, ¶ 257.
41 *Id.* ¶¶ 257-61.
42 *Enron Co. Ponderosa Assets, L.P.*, ICSID Case No. ARB/01/3, ¶ 305.

requirement of Article 25 (2)(b) was not met.[43] The *LG&E* tribunal, sharply contradicting the conclusions reached by the *Enron* tribunal, stated that "There is no serious evidence in the record that Argentina contributed to the crisis resulting in the state of necessity."[44]

The Argentina-U.S. BIT also contained an emergency clause precluding liability due to measures necessary for the maintenance of public order or national security.[45] The *Enron* tribunal stated that the application of this clause should satisfy the same threshold of the necessity defense in customary international law, and hence denied Argentina using it to its defense as well.[46] The *LG&E* tribunal, contradicting the *Enron* tribunal again, stated that the defense was applicable for the measures contested in the claim.[47]

B. Summary

Those contradictions indicate how difficult it is for tribunals to decide the available alternatives for a state when operating under stress with limited time to evaluate the risks or examine other available options. Indeed, such difficulties arise in any review of acts and measures made by a state in stressful conditions that are claimed to be an emergency situation – whether natural disasters, wars, or massive collapses of social and economic systems. Yet, in social and economic crises, the threat to human lives is usually indirect and the assessment is an issue of expertise. This makes it more difficult for tribunals to assess what emergency situation is sufficient enough to justify unlawfulness. For that reason, the tribunals in *Enron* and *LG&E* avoided bringing in economic opinions or examining any statements or conclusions made by economists.[48] While it is easier for a tribunal to determine a state of necessity after an earthquake or under a specific threat of a massive terror attack, it is more difficult for a tribunal to examine, in the context of an economic crisis, hypothetical scenarios of the result if the state acted differently—how far the state could endure the crisis until a total collapse of its systems and services

43 *Id.* ¶¶ 311-12.

44 *LG&E Energy Corp.*, ICSID Case No. ARB/02/1, ¶ 257.

45 Treaty between the United States and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investments, Arg.-U.S., art. XI, Nov. 14, 1991, 31 I.L.M. 124 [hereinafter Argentina Bilateral Investment Treaty] ("[T]his 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.").

46 *Enron Co. Ponderosa Assets, L.P.*, ICSID Case No. ARB/01/3, ¶¶ 333-39.

47 *LG&E Energy Corp.*, ICSID Case No. ARB/02/1, at ¶¶ 204-06.

48 *See* sources *supra* note 23; *see also supra* note 42 and accompanying text.

raised the likelihood of serious harm to human lives or the existence of the state.

Those contradictory conclusions naturally triggered many critiques on the system of investment treaty arbitration and the lack of precedent doctrine or institutional arrangements to minimize contradictions.[49] It is indicated that the necessity defense today does not meet the needs of a state undergoing an emergency situation due to an economic crisis, specifically because certain requirements, applied strictly, are difficult to meet in an economic crisis.[50] One outcome of those contradictory decisions is that states, when deciding on the proper measures to overcome an economic crisis, face a high level of uncertainty, which surely has a negative effect of the ability to decide on a sound and informed policy.

III. Compensations and Damages in International Investment Law: An Analogy of Private law

There are difficulties in applying the requirements of necessity in customary international law during a state of emergency caused by an economic crisis. Proving that the state's actions are the "only way" and that the state did not contribute to the emergency situation involves a high level of uncertainty and is hardly applicable for economic measures and an economic crisis.[51] Hence, it likely that a state undergoing an economic crisis, which poses a "grave and imminent peril" on an essential interest, takes non-discriminatory measures with due process of law, but nevertheless is found liable for damages if the measures do not qualify for other requirements of the necessity defense.

The necessity defense was developed within the use of force context in state-to-state disputes.[52] While the strict application of the necessity defense may be justified in that context, applying it to investor-state disputes in the context of economic crisis raises considerable challenges. An alternative solution may be a self-judging clause that can only be

49 *See* Kurtz, *supra* note 8; *see also* Alvarez & Khamsi, *supra* note 26; Andrea K. Bjorklund, *Emergency Exceptions: State of Necessity and Force Majeure*, *in* OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 459 (Peter Muchlinski et al eds., 2008); William W. Burke-White, *The Argentine 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); Michael Waibel, *Two Worlds of Necessity in ICSID Arbitration: CMS and LG&E,* 20 LEIDEN J. INT'L L. 637 (2007).

50 *See* Burke-White, *supra* note 49, at 220; *see also* Waibel, *supra* note 49, at 642.

51 *See supra* notes 39-42 and accompanying text.

52 *See* Kurtz, *supra* note 8, at 338.

scrutinized through good-faith principle.[53] Such a clause precludes liability of states for a non-discriminatory, bona fide act taken with due process of law and aimed at recovering from an economic crisis. Other suggestions offer a more tempered necessity clause adaptable to economic measures. The tribunal in *Continental Casualty* expressly captured this understanding when invoking necessity defense as articulated in the General Agreement on Tariff and Trade (GATT).[54] Sykes also suggests adopting specific requirements for economic necessity that are, in his opinion, more relevant than the requirements in the ILC draft article for invoking necessity.[55]

Neither suggestions for a "self-judging" rule nor for a more tempered necessity clause resolve the need to avoid excessive costs for one party or offer a method to bring a more balanced allocation of damages. We argue here that the plea of necessity in the context of investment treaty arbitration actually has more acute implications for states when it is considered along with the way that damages are ordered and valuated. Focusing on the necessity defense alone leads to an "all or nothing" solution, where regardless of whether a necessity defense is accepted, one party bears all the costs.[56] Our argument is that, in a moment of crisis, other policy considerations should be taken and the current method for damage evaluation restricts a tribunal's ability to take such considerations. This is elaborated in the following section.[57]

Precluding liability, as a self-judging rule states, may allow excessive costs to be laid on foreign investors, seriously damaging the potential for re-investing in that state in the future. Emergency clauses usually preclude liability except for discriminatory measures and hence do not prevent states from externalizing excessive costs on foreign investors. Discriminatory measures arise only when the same investors in

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53 This approach was taken in an expert opinion filed by Argentina and authored by Ann-Marie Slaughter. *See* Anne Van Aaken, *On the Necessity of Necessity Measures: A Response to Alan O. Sykes*, 109 AJIL UNBOUND 181, 184 (2017) [hereinafter Van Aaken, *On the Necessity of Necessity Measures*].

54 Continental Casualty v. Argentine Rep., ICSID Case No. ARB/03/9, Award, ¶ 192 (Sept. 5, 2008).

55 *See* Alan O. Sykes, *Economic "Necessity" in International Law*, 109 AJIL 296 (2015).

56 This dichotomy does not exist, however, when the necessity defense is accepted as Article 27 of the ILC suggests. According to Article 27(b), an exemption from liability for the application of the necessity defense does not deny the obligation for the payment of compensation for any material loss caused by the act. *See* ILC DASR, *supra* note 4, art. 27. As the commentary for the article explicitly indicates, compensation in the context of necessity differs from compensation for wrongful acts in other contexts, though it does not indicate how compensation should be assessed in the context of necessity. *See id.* This article, however, does not necessarily set an obligation to the payment of compensation, but rather allows the competent tribunal to decide. *See id.*

57 *See* Kurtz, *supra* note 8, at 343.

the same situation are treated differently.[58] Hence, a certain state measure that places costs on a group of investors, most of whom are foreigners, may indeed be motivated by that fact, but would not be considered discriminatory if a small minority of that group consisted of nationals.

The case of the recent economic crisis in Cyprus is an example where a self-judging clause or an emergency clause precluding liability was used excessively by the state leaving the investor with no available remedy. In 2013, following the Greek foreign debt crisis, the Cypriot banking system collapsed due to the fact that it was heavily invested in Greece. The bank of Cyprus, as a part of a ten billion Euro international rescue plan, seized depositors' uninsured savings above one hundred thousand Euros. Huge amounts of foreign capital, estimated as more than fifty percent of deposits, were invested in Cypriot banks due to relatively relaxed tax and financial regulations.[59] Hence, it was known that the primary victims of such a measure were foreign citizens, in addition to the Cypriot citizens. Moreover, it was also suggested that those foreign investors, mainly Russian nationals, were actually targeted by European states involved in negotiating the rescue plan, as their deposits in Cypriot banks raised concerns for tax evasion.[60]

Today, less than three years after the crisis, Cyprus has recovered and its economy is booming, even though thirty percent of total bailout funds were not used.[61] The rapid recovery from the economic crisis, as well as the fact that the bailout plan did not include the bailout of the Bank of Cyprus and laid costs on depositors, may raise concern over whether excessive burden was laid on foreign investors. Most investment treaties signed by Cyprus include an emergency clause precluding liability in a state of emergency but for discriminatory measures.[62] As

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58 *See* Argentina Bilateral Investment Treaty, *supra* note 45; *see also* discussion *infra* notes 62, 139-141.

59 Ian Traynor, Josephine Moulds, Miriam Elder & Howard Amos, *Cyprus Bailout Deal with EU Closes Bank and Seizes Large Deposits,* THE GUARDIAN (Mar. 25, 2013, 11:12 AM), https://www.theguardian.com/world/2013/mar/25/cyprus-bailout-deal-eu-closes-bank.

60 Andrew Higgins, *Cyprus Bank's Bailout Hands Ownership to Russian Plutocrats*, N.Y. TIMES (Aug. 21, 2013), https://www.nytimes.com/2013/08/22/world/europe/russians-still-ride-high-in-cyprus-after-bailout.html.

61 Holly Ellyatt,*That was Quick! Cyprus Exits Bailout with Cash to Spare*, CNBC (Mar. 10, 2016, 5:09 AM), https://www.cnbc.com/2016/03/08/that-was-quick-cyprus-exits-bailout-with-cash-to-spare.html.

62 *See* Agreement between the Belgo-Luxembourg Economic Union and the Republic of Cyprus on the Reciprocal Promotion and Protection of Investments, Belg.-Cyprus, art. 4, Feb. 26, 1991 [hereinafter Cyprus-BLEU BIT] ("Investors of one Contracting Party whose investments suffer losses owing to war or other armed conflict, revolution, a state of national emergency or revolt in the territory of the other Contracting Party shall be accorded by the latter Contracting Party treatment, as regards restitution, indemnification, compensation or other settlement, no less

treaty clauses preclude liability but for discriminatory measures in the case of emergency, it is doubtful whether the actions taken by Cyprus would be found discriminatory; such claims are being deliberated.[63]

Another aspect that arises from the Cypriot case, when considering a necessity defense or an emergency clause, is the involvement of third parties in negotiating and concluding bailouts and rescue plans for states undergoing an economic crisis. A state that is going through an economic crisis is likely to seek aid from international organizations or foreign states. As is the case for EU states such as Cyprus and Greece, those states lose a considerable margin of discretion.[64] However, the parties that negotiate the plan do not necessarily have the same interests as the state nor are their interests aligned with those of foreign investors. Hence, as those parties may take undesirable considerations and externalize costs excessively on others, their motives cannot be taken into consideration in a claim between a foreign investor and the state.

The argument on the issue of remedies is that public law remedies should be provided when an economic crisis occurs. The suggestion that public law should play a more significant role in the regime of investment law was raised on various issues,[65] but its potential contribution to the issue of remedies has yet to be further explored. In what follows, we examine the normative framework of remedies in international investment law and find that public law remedies for the compensation of victims of mass disasters provide a helpful field for applying the proper

favourable than that which the latter Contracting Party accords to the investors of the most favoured nation."). Similar articles can be found in the Agreement on the Promotion and the reciprocal Protection of Investments Between the Council of Ministers of the Republic of Albania and the Government of the Republic of Cyprus, Alb.-Cyprus, art. 4, August 5, 2010 ("Investors of either Contracting Party who suffer losses of their investments in the territory of the other Contracting Party due to natural calamity, state of emergency or disaster, war or other armed conflict in the territory of the other Contracting Party shall be treated, with respect to the compensations for these losses, as investors of third countries.").

63 Theodoros Adamakopoulos v. Rep. of Cyprus, ICSID Case No. ARB/15/49 (2015).

64 *See* Mark Dawson, *The Legal and Political Accountability Structure of 'Post- Crisis' EU Economic Governance*. 53 J. COMMON MKT. STUD. 976 (2015); *see also* Vivien A. Schmidt, *Forgotten Democratic Legitimacy: "Governing by the Rules" and "Ruling by the Numbers" in* THE FUTURE OF THE EURO 90 (Mark Blyth & Matthias Matthijs, eds., 2015).

65 STEPHAN SCHILL, INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW, (Oxford University Press, 2010); Stephan W. Schill, *Enhancing International Investment Law's Legitimacy: Conceptual and Methodological Foundations of a New Public Law Approach,* 52 VA. J. INT'L L. 57 (2011) [hereinafter Schill, *Enhancing International Investment Law's Legitimacy*]; *see also* Anne Van Aaken, *Primary and Secondary Remedies in International Investment Law and National State Liability: A Functional and Comparative View*, *in* INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW (2010) [hereinafter Van Aaken, *Primary and Secondary Remedies in International Investment Law and National State Liability*] (specifically on the issue of remedies).

remedial system for the damages caused to foreign investors following state measures to escape an economic crisis.

A. The Legal Framework of Remedies

The issue of remedies in investment treaty arbitration is hardly addressed in treaties. Treaties usually address damages only for cases of lawful expropriation, which are not considered a violation of a treaty.[66] Most treaties state that an investment shall not be expropriated, directly or indirectly, unless for a public interest, with due process, in a non-discriminatory manner and subject to a requirement of compensation.[67] The requirement of compensations may vary from one treaty to another; some explicitly state a fair market value and others simply require fair compensations, while all demand compensation be immediate and effective. In any case, the most common practice is to set the damages according to fair market value, regardless of the evaluation method used.[68]

However, fair market value is only relevant when the expropriation is lawful, and most treaties do not state a remedy for unlawful expropriation.[69] The remedy for violating other standards–such as fair and equitable treatment or full protection and security– is also not stated in most treaties. This leaves customary international law as the guiding authority on remedies as well as the matter of unlawful expropriation. Customary international law sets restitution as the remedy for internationally wrongful acts:

> [R]eparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it—such are the

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66 Investment treaties usually follow the customary international law standard of which a state is allowed to expropriate property of aliens only for a public purpose, in due process of law and in a non-discriminatory manner subject to fir compensations. On the development of the customary international law standards on expropriation, *see* DUDOLF DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 90-91 (2nd ed. 2012).

67 *Id.* at 93.

68 For an extensive discussion on the distinction between compensation for lawful and unlawful expropriation, *see* ADC Affiliate Ltd. and ADC & ADMC Mgmt. Ltd. v. Rep. of Hung., ICSID Case No. ARB/03/16, Award, ¶¶ 479-499 (June 2, 2006).

69 *Id.*

> principles which should serve to determine the amount of compensation due for an act contrary to international law.[70]

The articulation of this rule in the ILC DASR is slightly different, bringing restitution and compensation as available remedies in combination or separately:

> Article 31. Reparation
>
> 1. The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act.
>
> 2. Injury includes any damage, whether material or moral, caused by the internationally wrongful act of a State.
>
> . . .
>
> Article 34. Forms of reparation
>
> Full reparation for the injury caused by the internationally wrongful act shall take the form of restitution, compensation and satisfaction, either singly or in combination, in accordance with the provisions of this chapter.[71]

While there is no doubt that those rules are applicable for a state bringing a claim against another state for an injury suffered by a non-state entity,[72] it is doubtful those rules apply for an investor bringing a claim against a state. The judgment of *Chorzow Factory* stated that different rules apply in the relations between the state who is claimed to have committed a wrongful act and an individual who has suffered damage.[73] Accordingly, applying those roles to a violation of an international investment agreement raises difficult questions as to how restitution is evaluated when the breach is of standards such as fair and equitable treatment or full protection and security. The uncertainty of the proper method of evaluating restitution in these cases leaves a relatively high level of leverage and discretion to the tribunals, as the tribunal in *S.D. Myers v. Canada* clearly states:

> By not identifying any particular methodology for the assessment of compensation in cases not involving expropriation, the Tribunal considers that the drafters of the NAFTA intended to leave it open to tribunals to determine a measure of compensation appropriate to the

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70 The Factory at Chorzów (Ger. v. Pol.), Judgment, 1928 P.C.I.J. (ser. A) No. 17, at 25 (Sept. 13).

71 ILC DASR, *supra* note 4, art. 31.

72 *Id.* at 27-28. *See also* ILC DASR, *supra* note 4, art. 33 & commentary at 95; KEVIN WILLIAMS & SERGEY RIPINSKY, DAMAGES IN INTERNATIONAL INVESTMENT LAW 31 (2008).

73 Factory at Chorzów, *supra* note 70. (stating "[t]he rules of law governing the reparation are the rules of international law in force between the two States concerned, and not the law governing relations between the State which has committed a wrongful act and the individual who has suffered damage . . .").

> specific circumstances of the case. . . whatever precise approach is taken, it should reflect the general principle of international law that compensation should undo the material harm.[74]

In practice, however, tribunals often follow private law methods for evaluating the amount of compensation. Those methods vary. One practice, when the injury destroys the investment, is to assess the fair market value of the investment as in the case of lawful expropriation.[75] When the injury only partially decreases the value of an investment, or the economic benefit from it, then other methods may be applicable: lost net income, lost dividends, lost invested amounts, and other methods often tailored to the specific case and to the manner in which the agreement was breached.[76]

B. The Separation Between Lawfulness and Damages in Emergency Situations

As in private law, denying necessity renders the state liable for the damage caused by the unlawful act, and the circumstances leading to that act then are no longer considered.[77] In addition, the type of obligation that is breached and the public interest behind this breach are irrelevant for the rules prescribing the assessment of compensations.[78]

The treatment of damages in *Enron* is an example of such separation. Examining the valuation of damages shows that once the necessity defense is denied, the state of emergency is no longer addressed or considered for the valuation of damages. Accordingly, the *Enron* tribunal denied the relevance of the country risk to the value of the investment or the relevance of the positive effects of the economic crisis on the claimants' non-regulated sectors.[79] Hence, the amount of compensation was based on fair market value of the business as if the circumstances

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74 S.D. Myers, Inc. v. Gov't of Can., Partial Award, U.S.-Can. 309, ¶ 315 (Nov. 13, 2000).

75 RUDOLF DOLZER & CHRISTOPHER SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 91-92 (2008).

76 *See generally* Williams & Ripinsky, *supra* note 72, at 88-99.

77 An exception may be found in the ILC DASR. Article 27 allows tribunals to order compensation for wrongful acts even if those acts satisfy the necessity defense. *See* discussion *supra* note 56 and accompanying text on Article 27.

78 *Id.* at 90.

79 Enron Co. Ponderosa Assets, L.P. v. Argentine Rep., ICSID Case No. ARB/01/3, Award, ¶¶ 378, 402, 415 (May 22, 2007). The tribunal only considered the economic crisis relevant for the time period set for the tariff adjustment. Instead of setting the period for one year, the tribunal set the period for six years allowing a better spread of weighted average cost of capital (WACC), which is the average return of business. Eventually, this adjustment had little effect on the amount of compensation.

have (almost) never changed. A similar approach was followed by the tribunals in *CMS v. Argentina*[80] and *Sempra v. Argentina*.[81]

The separation between the considerations to determine lawfulness and the considerations for damages may not be desirable in cases of economic crises if the necessity defense is denied. In fact, an economic crisis remains relevant for the valuation of damage even if it did not satisfy the conditions for applying the necessity; First, evaluating the damage demands taking the profitability of the investment during an economic crisis, which is naturally lower than the profitability in a stable economy.[82] To assess damages we need to assume that the regulatory framework remained unchanged. But it is often that the moment of crisis is a moment for abandoning the existing regulatory framework and adopting a new one. In such a case, assessing damages based on the former regulatory framework serves only one purpose, corrective justice.[83] But, corrective justice should not be the preferred normative assumption behind international investment law. Rather, consideration for stabilizing or developing the economy should be assigned a primary role when an economic crisis occurs. Moreover, stabilizing the economy benefits the investor already invested in the state. This benefit is not captured when we only focus on the direct damage suffered by the investor and ignore the shared interest of stabilizing the economy.

The second argument is that in moments of economic crisis the system of remedies should be adapted to support the economy and be prioritized over considerations such as corrective justice, focusing on the relations between the state and the investor as private actors. This argument may take place in two aspects: the macroeconomic aspect and the microeconomic aspect. The macroeconomic aspect, raised by Yair Listokin, suggests that law should encourage spending more in recessions than it does in ordinary times. [84] When it comes to remedies, Listoken

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80 CMS Gas Transmission Company v. Rep. of Arg., ICSID Case No. ARB/01/8, Award, ¶ 410 (May 12, 2005).

81 *Sempra Energy International v. Argentine Rep.*, ICSID Case No. ARB/02/16*,* Award, ¶ 404 *(Sept. 28, 2007)*.

82 The tribunal in *ITT Industries v. Iran* has taken such an approach with regards to the reduction in value of property following the Islamic revolution in Iran. According to this approach, while the act of taking cannot be taken into consideration when evaluating the value of the property, the revolution is not a wrongful act, and its effect on the value of property should not be ignored. *See* ITT Industries, Inc. v. Islamic Rep. of Iran., Iran-U.S. Cl. Trib., Case No. 47-156-2, (May 26, 1983), 77 AM. J. INT'L L. 891, 893 (1983).

83 For the definition of corrective justice, *see* Ernest Weinrib, *Corrective Justice in a Nutshell*, 52 UNI. TORONTO L.J. 349 (2003).

84 Yair Listokin, *Law and Macroeconomics: The Law and Economics of Recessions*, YALE L. SCH. LEGAL SCHOLARSHIP REPOSITORY (2017).

argues, courts should be more inclined during recessions to award "specific performance" remedies, preferring remedies that are more likely to raise output.[85] Moreover, unsustainable levels of debt in the books also affect the rate at which a country can borrow on international capital markets, potentially prolonging the crisis.[86] Compensating the investors for their damage, including expected profit, may incentivize investors to abandon their investment.[87] Hence, from a macroeconomic perspective, the proper system for reparation is not one that compensates for full losses but rather one that recovers the damage to the investor through recovering the investment itself and assuring its continuation.

Third, economic crises demand structural reforms in the economy. Such reforms are likely to cause losses to some actors in the market, many of which are foreign investors protected by investment agreements. It follows that a state going through an economic crisis is likely to face multiple claims by foreign investors, each deliberated separately and without consideration for the state's capacity to pay and the uncertainty that investors face in complying with the awards. When it comes to a severe economic crisis it is clear that states may lack the capacity to compensate for the damages occurred or that those damages may burden their financial obligations.

Hence, an economic crisis is not only relevant to the application of necessity but should also be considered when the valuation of damages is made. As mentioned earlier, investment treaty tribunals—when it comes to non-expropriatory violations of treaty—should not necessarily be bound by the remedies available in customary international law; policy considerations may also play a role in the choice of remedies. The *LG&E* tribunal chose an alternative method for the valuation of damage, which seems to be shaped through alternative policy considerations about corrective justice.[88] The tribunal denied both the assessment of future lost profits and of the devaluation of worth in the stock market as methods for determining market value, finding them both too speculative.[89] Instead, the tribunal valuated compensation based on the dividend that *LG&E* would have received from its subsidiaries in Argentina had Argentina not

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85 *Id.* at 39.

86 *See* Van Akken, *supra* note 53, at 185.

87 For discussion on the impact of full compensations on the investor *see* Sykes, *supra* note 55, at 321; Lawrence Blume & Daniel L. Rubinfeld, *Compensation for Takings: An Economic Analysis*, 72 CAL. L. REV. 569 (1984).

88 *See generally* LG&E Energy Corp. v. Argentine Rep., ICSID Case No. ARB/02/1, Award, (Jul. 25, 2007).

89 *Id.* at ¶¶ 33-40; *id.* at ¶¶ 59-60.

abrogated the tariff regime, which was shaped to encourage investors[90] Yet, it should be indicated, that the tribunal calculated the loss of dividends only up to February 2005, the date at which actual loss was proven.[91] By doing so, the tribunal acknowledged that Argentina was in continued breach of the treaty and expressed its anticipation that such recognition was an "incentive to Argentina to restore the tariff regime or a least to engage in genuine arms-length negotiations to avoid future condemnatory decisions."[92] The *LG&E* tribunal actually gave Argentina the opportunity to reconsider its new policy that was shaped under stressful circumstances and to renegotiate the conditions of the tariff policy.[93] In any case, while policy consideration may have been implicitly considered, the tribunal, in its explicit reasoning, remained committed to the separation between damage and liability.

Fourth, considerations for the separation between liability and damages as corrective justice requires, are heavily justified by the risk that states could act hastily when they are able to externalize the damage.[94] Sykes states, while following this line of argument, that by internalizing the damage caused to investors a moral hazard is avoided by inducing state decision makers to make the appropriate decisions.[95] A strict allocation of investor protection rules, however, would not solve the problem of moral hazard as the political officials responsible for imprudent policies are not expected to bear the costs. Hence, Sykes eventually suggests coupling the use of a necessity defense with the need to pay compensation for damages appropriately tempered to allow states facing economic emergency to recover before paying damages.[96]

Indeed, following a bounded rationality model, we doubt the ability to calculate the costs and benefits of actions taken by states with regard to foreign investors when a risk for economic crisis exists. Economic crises involve grave losses to the state's economy, with a much higher level of uncertainty regarding actual value compared to the costs that are usually considered in tort law or contract law when a stable normative framework is assumed. While the unlawful act in contract law and tort law usually occurs for a short period of time, after which it is possible to evaluate its actual value, the costs of an economic crisis continue to

90 *Id*. at ¶ 59.

91 *Id*. at ¶ 60.

92 *Id*. at ¶ 97.

93 *Id*. at ¶¶ 81-83.

94 *See* Sykes, *supra* note 55, at 321-22.

95 *Id*.

96 *Id*. at 320.

increase as long as the crisis is not managed and controlled by the state, and its actual cost is only realized after several years.

The risk of externalizing costs on foreign investors, however, is more likely once an economic crisis emerges. Politicians, while considering the distributive effects of their decisions, may externalize excessive costs on foreign investors to avoid increasing the financial burden on the local public who may be already frustrated with the economic policy of incumbent decision makers due to the crisis. The risk is higher if we consider that some politicians are more likely to resort to populism and indicate foreign involvement or foreigners as responsible for the crisis. Hence, we argue that the risk of moral hazard is more relevant to consider after an economic crisis emerges, along with the shared interest of recovering from an economic crisis.

Finally, it is notable that the debate about the necessity defense in customary international law and in investment treaty law does not distinguish between different kinds of liabilities. Sykes examines tort law and contract law in addition to international law but does not address whether a different context may demand different analogies.[97] If we attempt to consider this question, we may realize that different kinds of treaty breach may require different kinds of interpretations for the necessity defense. State measures may cause damages to investors with or without contractual relations. State measures to recover from an economic crisis may include revising or annulling existing contracts, defaulting on the payment of bonds, and freezing or expropriating financial assets. Do all measures carry the same considerations with regards to efficiency or regards to cost allocation? In international investment law, the remedy for expropriation of property is distinct from remedies for treaty violation and treaties usually include a specific rule stating that fair market value, or adequate compensations, should be paid in case of expropriation.[98] Economic assessment of damages, however, may not eventually distinguish between costs incurred due to lost future profit or due to expropriation of property, especially when the contract is considered an asset and its value is assessed through future profit.[99] However, the law generally does distinguish between costs incurred from lost future profit and expropriation of property, as the distinction between

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97 Sykes, *supra* note 55, at 298-302.

98 DOLZER & SCHRUER, *supra* note 66; ADC Affiliate Limited v. Rep. of Hung., ICSID Case No. ARB/03/16, Award, ¶¶ 479-499 (Oct. 2, 2006).

99 *See generally* Leif Wenar, *The Concept of Property and the Takings Clause*, 97 COLUM. L. REV. 1923 (1997) (providing a critique of the expropriation doctrine and its development to cover tangible and intangible property indistinctively.)

liability rules and property rules suggests. This distinction also exists in international law, as well as BITs, and the justification for this distinction may fall into the principle of cost allocation rather than corrective justice, as tort law or contract law may imply. While expropriation of property places immediate costs on investors, the breach of a contract causes, inter alia, loss of future profits and allows more leverage for investors to minimize costs by finding alternative investments. While this distinction between actual loss and future loss may not be relevant when microeconomic analysis is followed, it may lead to a different conclusion if macro-economic analysis is considered in cases of economic exigency.

By now, we have argued that the separation between liability and remedy, as private law dictates, is not necessarily the most desirable model for managing investor claims during an economic crisis. Specifically, we argue that such a separation does not provide the proper allocation of costs between the state and the investors, and certain considerations demand a different model for cost allocation. In the following section, we indicate the absence of public law in the system of remedies, which limits the ability to break down such a distinction and to provide a different allocation of costs.

IV. MODELS FOR COMPENSATING DISASTER VICTIMS IN NATIONAL LEGAL SYSTEMS

Investment treaty arbitration is often addressed as a field of law that combines public international law, private international law, and public law. Public international law is relevant because investment agreements are first and foremost based on treaties between states. Public international law governs the interpretation of treaties and is the applicable law in most contexts.[100] Private international law is relevant because the dispute settlement mechanism is based on the model for commercial arbitration which grafts private international law dispute resolution mechanisms onto public law treaties.[101] For a long time, investment treaty arbitration was considered part of international commercial arbitration; furthermore, the law firms specializing in the

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100 *See* Anthea Roberts, *Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System*, 106 AM. J. INT'L L. 45 (2012); Stephan W. Schill, *Crafting the International Economic Order: The Public Function of Investment Treaty Arbitration and its Significance for the Role of the Arbitrator,* 23 LEIDEN J. INT'L L. 401, 404 (2010) [hereinafter Schill, *Crafting the International Economic Order*]; ALEX MILLS, *The Public-Private Dualities of International Investment Law and Arbitration,* EVOLUTION IN INVESTMENT TREATY LAW AND ARBITRATION 97 (Chester Brown & Kate Miles eds. 2012).

101 Zachary Douglas, *The Hybrid Foundations of Investment Treaty Arbitration*, 74 BRIT. Y.B. INT'L L. 151, 151-55 (2004); Roberts, *supra* note 100, at 45.

field of arbitration, the arbitrators, and the arbitration centers, primarily emerged from the community of international commercial arbitration.[102] Finally, public law is relevant because investment treaty tribunals are shaping the normative framework for state conduct with investors, a relation in which investors are governed by the regulative framework set by states.[103]

The principles governing the methods for evaluating damages in investment treaty arbitration are influenced by public international law and private international law. Common to those two fields of law is the centrality of the contract, reflecting the free will of two parties in shaping their relation. For this reason, the remedies in both fields overlap and, once a breach is found, then restitution or compensation for the full damages are the preferable remedies.[104] Moreover, as most arbitrators emerge from the community of international commercial arbitration, the methods they are familiar with to assess and calculate damages emerge from the field of commercial arbitration as well. Public law remedies, however, are not reflected in the system of remedies in economic crises. National legal systems are usually available to investors, but investors are more likely to prefer international arbitration, for several reasons—such as the concern from biased courts, lower compensation due to a different remedial system, or lower standards for the state to satisfy—compared to investment treaty arbitration.[105]

Convergence between public law remedies and international investment law remedies were suggested through the distinction between primary and secondary remedies.[106] Primary remedies, such as rescission or mandatory injunctions, are remedies aimed at preventing illegal acts by the executive.[107] Secondary remedies are compensatory and aimed at pecuniary damages.[108] While most public law systems require the use of primary measures before the use of secondary ones, identified with a two-stage-system of remedies, international investment law, in general, only

102 *See* YVES DEZALAY & BRYANT G. GARTH, DEALING IN VIRTUE: INTERNATIONAL COMMERCIAL ARBITRATION AND THE CONSTRUCTION OF A TRANSNATIONAL LEGAL ORDER, 6-8 (1996); Moshe Hirsch, *The Sociology of International Investment Law*, *in* THE FOUNDATIONS OF INTERNATIONAL INVESTMENT LAW: BRINGING THEORY INTO PRACTICE 143 (Z. DOUGLAS, J. PAUWELYN, & J.E. VIÑUALES, ed. 2014).

103 *Schill, Enhancing International Investment Law's Legitimacy*, *supra* note 65, at 59.

104 *See generally* ADC Affiliate Limited v. Rep. of Hung., ICSID Case No. ARB/03/16, Award, ¶¶ 479-504 (Oct. 2, 2006).

105 DOLZER & SCHREUER, *supra* note 66, at 235-236.

106 *See generally* Van Aaken, *Primary and Secondary Remedies in International Investment Law and National State Liability*, *supra* note 65, at 722.

107 *Id.* at 724-25.

108 *Id.* at 724.

applies secondary remedies.[109] Hence, convergence between the two systems of remedies requires examining methods to adhere to the primary system of remedies before applying secondary remedies in international investment law.[110] While this suggestion may seem relevant in normal circumstances, it is more challenging in emergencies, as it undermines the executive's ability to take immediate and urgent measures. The review of executive acts during an emergency is far less agreed upon than in normal circumstances. Debates on this issue cover the timing of judicial review, the extent to which the review should be applied, the topics applicable to review, and, most importantly, the effectiveness of the review.[111] While similar considerations may be applied to remedies available for foreign investors during an economic crisis, this discussion exceeds the scope of this article. Nevertheless, we would note that the effectiveness of primary remedies in moments of crisis are much more doubtful regarding foreign investors. It is not only that foreign investors are less likely to be prioritized against national interests during emergency, but also because it is less likely for the courts to intervene to preserve contractual and economic interests with no implications over physical security or individual political freedom, as is the case for most investor claims.

Public law, however, can contribute to the remedies in international investment through the models that exist in national legal orders for compensating victims of disaster or crisis in the states. Examining the existing models in national legal systems for compensating victims of disasters, however, suggests that moments of mass disaster require a specific system of remedies tailored and adapted to the specific needs and considerations in the moment of crisis. As this comparative study shows, the available methods and mechanisms in the national legal systems may vary from private law mechanisms to public law mechanisms and hybrid mechanisms not necessarily contained within one of those fields. As such, they provide a more desirable allocation of damages between foreign investors and states or to offer a mechanism for realizing such an allocation. This allocation is possible as those models are not necessarily restricted to separation between liability and remedy, nor to the distinction between state and private markets.

Comparative studies show that legal systems offer various models for the compensation of victims in the context of national crises and

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109 *See id.* at 764.

110 *Id.* at 746-50.

111 It is often suggested that courts are more likely to defer to the executive's discretion during emergencies.

disasters[112] There are four models: (1) liability rules and social security rules; (2) private risk insurance; (3) mandatory risk insurance realized through public-private cooperation; and (4) creating a compensation fund for victims.[113] In what follows, we examine those models and their applicability, specifically, advantages and disadvantages for both states and investors in managing multiple treaty claims due to an economic crisis. In doing so, we depart from the focus on the relationship between the investor and the state as a unit of analysis isolated from the nature of the economic background on which that relationship is defined. Recovering from an economic crisis is not only a public interest that the state is aiming to pursue, but rather a shared interest between the state, the investor, and the international community.

A. Default Liability Rules

Some states do not have regulations tailored to compensate victims of disasters. In those states, victims rely on default regulations such as liability rules or social security regulations. Liability rules are particularly relevant in the case for man-made and technological disasters, where a specific legal personality may be found liable for the damage. In natural disasters, however, there is usually no liable personality for the damages so social security rules apply. Both cases share the risk of insolvency, which makes those regulations work only as far as the solvency of the liable personality or the default compensation fund is guaranteed. Corrective justice is a consideration for supporting liability rules, of which a person who committed tortious act should restore the damage caused by that act.[114]

Investment treaty arbitration has several features similar to the liability rules framework. Just as tort law is not tailored for mass disasters, investment treaty arbitration is a default mechanism not necessarily tailored for economic crises. As in tort law, a foreign investor should prove the liability of the state based on an investment treaty. The scope of considerations in allocating costs is rather limited, as the state is either liable for damage or not. If it is liable, then the methods for evaluation of compensation are similar to those available in private law.

Default liability rules, however, are considered the least preferable mechanism for disaster recovery programs, largely because they do not set a limit for the funds that are to be allocated to compensate victims.

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112 *See* Faure, *supra* note 2.

113 *See* Faure, *supra* note 2.

114 Faure, *supra* note 2, at 342-4.

After a crisis, the state resources are distributed to the compensation of victims as well as for recovery programs that are required for infrastructure and services. Default liability rules do not allow for a proper allocation of resources between the various needs.[115]

Those considerations stand for investment treaty arbitration as well. Corrective justice suggests that each party should be liable for the damage that he unlawfully caused, and hence an investor should be compensated by the state for an act that violates international law. In economic crises, as in mass disasters, however, other policy considerations are required such as the solvency of the state, the priority for providing essential public expenditures, and the safeguarding of minimal conditions for living to the nationals of the state. While investment treaty arbitration focuses on the relationship between state and investor, those considerations do not play a role in determining remedies. Moreover, as economic crises produce the possibility of mass claims, of which a state may be found liable and ordered to pay huge amounts of money, the benefit of non-compliance becomes very high and more tempting.

Finally, liability rules are also less desirable because they are often settled through deliberation in courts, which involves a high level of uncertainty and long, costly proceedings. Deliberation in courts may also negatively affect the relations between the parties, an effect that is difficult to restore later. Investment treaty arbitration also shares this disadvantage as arbitration proceedings are often characterized by mutual suspicion between the parties, which makes it difficult for them to resume their economic and business relations in the future.

B. Risk Insurance

Risk insurance is often suggested as an ex ante precautionary measure for disaster recovery and has many advantages often highlighted in the literature.[116] First, risk insurance leads to a better calculation of risk for the purpose of adaptation to premium policy costs.[117] In the case for foreign investors, it provides a better calculation of risk compared to the economic benefit from the investment. Usually, a risky investment involves a higher rate of return on profit for the investor. Accordingly, an investor should be the one bearing the risk as the cheapest insurer.

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115 *Id.* at 344.

116 *Id.* at 344-45.

117 *See generally* George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521 (1987).

Yet, investors may decide not to purchase an insurance policy if the risk is carried by the state through the international investment law regime.[118] By laying insurance costs on the investor, cost-benefit analysis made by the investor may be more efficient both for investors and states than default liability rules in international investment law. Support for this assumption may be found when considering that Enron made profits from the same currency exchange that caused the losses for which Enron sued. While the tribunal refused to consider those profits as relevant to evaluating the damages, the profits clearly indicate that Enron could have secured its investment elsewhere.[119]

Insurance, however, is not available for all kinds of damages caused by economic crises. Van Aaken indicates hedging as a proper risk insurance for currency fluctuation.[120] Hedging, however, is not always possible. First, the return on profits should be high enough to cover the costs of hedging. This is especially true because hedging becomes more expensive for securing a fluctuating currency. Second, in the particular case of Argentina, considering the peso-dollar fixed rate policy at that time, it is doubtful such hedging was available in the market or would have been anything but hedging for dollars.

This situation, however, does not apply for all cases of economic crises, as most states today do not follow fixed-pricing policy for currency exchange and few states would provide such a coverage for business risks that investors are used to taking. Economic crises may erupt in states known as having a non-stable economy, such as Argentina in 2000, or in states having the reputation of a stable economy, such as the U.S. in 2008.[121] While in the latter case it is assumed that the costs of hedging were relatively low, in the former case hedging was more expensive.[122] As mentioned earlier, risky investment such as investing in non-stable economies may be secured if the return rate on the investment is high enough to cover the costs of the insurance or the hedging. However, where costs of hedging are too high, investors may be deterred from entering in the economy.

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118 *See* Van Aaken, *On the Necessity of Necessity Measures*, *supra* note 53, at 184.

119 *See* Enron Co. Ponderosa Assets, L.P. v. Argentine Rep., ICSID Case No. ARB/01/3, Award, ¶¶ 311-12 (May 22, 2007).

120 Van Aaken, *On the Necessity of Necessity Measures*, *supra* note 53, at 184.

121 *See generally* INT'L MONETARY FUND, *supra* note 6.

122 This explains why when we bet on the expected trend for currency exchange the profit is smaller than if that expectation was realized. We need to buy more instruments in order to cover the expected damage. *See* UGUR LEL, *Currency Hedging and Corporate Governance: A Cross-Country Analysis*, 18 JOURNAL OF CORPORATE FINANCE 1, 31 (2012).

Currency fluctuation is one major risk in economic crises, but it is certainly not the only one. Economic crises involve significant economic reform, which usually changes the legal and economic framework taken into consideration when the investment was initially made.[123] A complementary insurance to hedging is political risk insurance, which is offered for foreign direct investments in the context of risks arising from political decision making. Political risk insurance usually covers "(1) war and political violence, (2) risks of expropriation/breach of contract, and (3) transfer risks."[124] Providers of such insurance may be private financial institutions, such as banks and insurance companies, or publicly owned institutions, such as OPIC (U.S. Governments' Overseas Private Investment Corporation) and Export Development Canada (EDC).[124] Finally, the World Bank's Multilateral Investment Guarantee Agency (MIGA) is considered one of the largest providers of political risk insurance to emerging markets.[125]

Political risk insurance has its own limitations as well. The coverage of political risk insurance may be followed by subrogation of claims. As subrogation of claims potentially arises where the insurer sues the state for a treaty violation, insurance does not exempt the state from liability under international law. In addition, political risk insurance coverage is highly expensive and does not cover all kinds of political risks.[126] In the context of investment claims, it is especially relevant when expropriation occurs and does not cover other treaty violations, such as fair and equitable treatment or discriminatory acts.

To summarize, first party insurance covers only part of the problem created by risks arising from economic crises. We should also recall that if the risk is carried by the state through the international investment law regime, investors may decide not to purchase insurance.[127] Moreover, cases where the returns of profits are not high enough to cover the costs of the insurance will require state interference to overcome this gap. This can be attained through a high return of profits in contracts with the states or through subsidizing insurance. For such state interference to be desirable, we should first assume that the benefits to the state of foreign

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123 In that case, the state may be in violation of the fair and equitable standard. *See Enron*, ICSID Case No. ARB/01/3, Award, at ¶¶ 260-62; CMS Gas Transmission Company v. Rep. of Arg., ICSID Case No. ARB/01/8, Award, ¶¶ 273-77 (May 12, 2005).

124 Nathan Jensen, *Political Risk, Democratic Institutions, and Foreign Direct Investment,* 70 J. POL. 1040, 1043 (2008).

125 *Id.*

126 *Id.* at 1044.

127 In the relation between liability rules and first party insurance; *see generally* Priest, *supra* note 117.

investments are higher than the costs. The first option–attaining high profits–is less desirable as it involves paying the costs even if the risk is not realized, and once it is realized, the state may be obliged to compensate for lost profits. The second option involves the payment of compensation, only if the risk is realized and through a long deliberation process, but the evaluation of damages may burden the state excessively. Compared to a situation where the investment treaty arbitration is the only mechanism available for the investor to claim his costs from the state, a risk-averse state may prefer the second option, intervening to guarantee the risk is covered through insurance.

C. Private-Public (Mandatory) Risk Insurance

Governmental intervention in the insurance market for mass disasters exists in some states.[128] Governmental intervention may take two strategies: the first is compulsory insurance on certain property holders; the second is compulsory coverage for certain risks when a party voluntarily seeks insurance for property. Naturally, state intervention may also extend to insuring the availability in the market for such insurance. [129]

In domestic legal systems, it is suggested that mandatory insurance is desirable to reduce public pressure on states to provide compensation schemes—not necessarily based on clear rules for entitlement and evaluation.[130] Naturally, this advantage is less relevant in regulating the remedies to foreign investors. In economic crises, the public pressure is focused inwards—on stabilizing the economy along with providing minimal welfare services and minimizing the effects of the economic reforms on layouts, pensions, and salary cuts. If foreign investors are considered in public opinion, it is more likely that public pressure would lead to externalizing the costs on the investors. Thus, in the context of economic crises, it is the concern of externalizing costs on foreign investors that compulsory insurance may alleviate.

For compulsory insurance to be helpful we need to deal with two sets of questions: what are the means to impose such insurance, and what kind of risks arising from economic crises should and may be covered by those insurance contracts? As far as the means are considered, mandatory insurance is easier to realize when the investment is based on a contract between the investor and the state, as such insurance can be agreed upon

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128 Faure & Hartlief, *supra* note 2, at 460.

129 *Id*.

130 Faure, *supra* note 2, at 352.

in the contract. States are more likely to avoid legislation imposing risk insurance on foreign investors as that could deter investors from entering into the market if the costs are high or may be considered discriminatory. The risks of liability for a breach of an investment treaty is lower, however, when there is no contract, if the emergency measures are non-discriminatory, and if it serves the public interest.[131]

Naturally, for such state interference to be desirable, we should first assume that the benefits of foreign investments to the state are lower than the costs of such actions. Mandatory insurance calculates the costs and benefits ex ante. Investors naturally internalize the costs of insurance into the calculation of profit and, if the costs are not high enough to cover those additional costs, the state may intervene to subsidize insurance costs. As such, mandatory insurance provides a better evaluation of the profitability of the investments for both states and investors.

Securing insurance through investor-state contract provides an additional advantage of securing the risk of subrogation of claims. Internalizing insurance in the contract allows an investment tribunal to examine the insurance as part of the economic value of the contract. Another way to overcome subrogation is to shape the insurance policy so that insurance is only paid against a waiver signed by the investor for any future claims based on an investment treaty if the damage is covered by insurance. To do so, cooperation between the state and the insurer should be obtained, and a state should try and induce financial institutions to offer such instruments. Hence, the possibility for filing a BIT claims remains possible, but it is more likely that investors would prefer insurance due to the risk of either losing the case against the state or engaging in costly litigation, compared to the certainty of the insurance payment.

The second question concerns the kinds of risks mandatory insurance is supposed to cover. Currently, hedging is an available instrument for transaction costs due to currency exchange.[132] But economic crises may cause other economic losses, such as the termination of contracts, insolvency of debtors, or the need to control the investor's property by the state. Political risk insurance is yet another available instrument for covering those risks when they are caused by

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131 *See, e.g.*, Methanex Corp. v. United States, Case No. 643 D002, Final Award of the Tribunal on Jurisdiction and Merits (NAFTA Arb. 2005), https://www.italaw.com/sites/default/files/case-documents/ita0529.pdf; *see also* Saluka Inv. BV v. Czech Rep., Neth-Czech, Partial Award, (Perm. Ct. Arb. 2006).

132 *See generally* Ugur Lel, *Currency hedging and corporate governance: A cross-country analysis*, 18 J. CORP. FIN. 221 (2012); *see generally* John Y. Campbell, Karine Serfaty-de Medeiros, & Luis M. Viceira, *Global Currency Hedging*, 65 J. FIN. 87 (2010).

state actions. The need that can be satisfied through political risk insurance may vary from one sector to another and from one kind contract to another.

To summarize, mandatory first-party insurance may offer a desirable solution as far as it is applicable, but it is limited to a certain kind of investors and certain kinds of risks. Providing a conclusive scheme for types of insurance and analysis for how they can mitigate the risks of both investors and states is naturally beyond the reach of this paper, which only delineates compensation schemes that could play a positive role in compensating foreign investors.

D. Legislation for Damages and Fund Allocation

According to this model, the state appoints a commission for allocating funds among those who claim damages due to an emergency situation. The advantage of such a fund is that it enables decision makers to allocate compensation while taking into consideration the aggregate damage caused by the disaster. The disadvantage, however, is that the allocation of the total amount of compensation to be distributed is set after the disaster occurs, while facing the grave damages of the disaster. [133] An ex ante design of the compensation scheme pressures decision makers to increase the amount of resources allocated to the fund and risks overcompensating and hence undermining equality among victims of disasters.[134] Moreover, such a commission, appointed ad hoc and after the disaster occurs, must deal with issues of procedure, allocation, and assessment of total damages, while issues of due process may be jeopardized.

Keeping those insights in mind, applying such a model for investor-state disputes after an economic crisis appears desirable if we take several considerations. These include: flexibility in shaping the rules for setting damages allows the commission to consider the capabilities of the state along with the necessary steps to recover from the prices; the commission evaluating the contractual relationship between the investor and the state from an economic perspective, which also takes into consideration the profitability of the investment as a whole; the overall actual effects of the crisis on the investor; the future profitability of the investor; the nature of the breaches and the damages caused to the investor; and, finally, the cumulative effect of all claims taken altogether. Naturally, the risk of overcompensating is low in this context as foreign investors are less

133 Faure, *supra* note 2, at 353, 359.

134 *Id.*

likely to gain the sympathy of the public, which is suffering from the crisis as well. Rather, there is a risk of externalizing the costs on the foreign investor.

The composition and working procedures of such commissions are crucial. We suggest the commission consists of economists, who are well informed of state capabilities and economic conditions, as well as international law experts, who can assist with avoiding future claims at the tribunals. While international law and investment treaty remain relevant, they are not the only considerations to be taken. Naturally, introducing an economic expert into the commission is necessary to decide issues of economic expertise. Also, a commission consisting of both national and international legal experts alleviates the concern of externalizing costs on foreign investors on the one hand, and of ruling an amount of compensation that does not take the state's economic and political conditions into account, on the other hand. Hence, a mixed commission of national and international experts is also meant to retain the necessary confidence of both parties in the procedure to ensure their cooperation.

As mentioned above, such a commission should also set a realistic timetable for the payment of compensations. The situation in Argentina demonstrated that, for states recovering from economic crises, recovery is necessary for the state to be both able and willing to comply with the award. Consideration for recovery in the commission's decisions, as well as the fact that the commission was suggested by the state in the first place, makes it more likely that the state is willing to comply with these decisions.

Several options are available to increase investor confidence in the commission. The state could suggest that one member of the commission is appointed by an international institution, such as the International Monetary Fund (IMF) or the World Bank's International Centre for Settlement of Investment Disputes (ICSID). In addition, the state could offer that one member is appointed by the other contracting state in the relevant BIT, if the investors all, or most, emerge from one state. The state could also appoint a team of international economic experts advising the commission on issues concerning their expertise.

Such a commission does not prevent investors from turning to international tribunals for settling claims, as exclusion of local remedies is usually not required before filing a treaty claim.[135] However, some tribunals decided that non-exclusion of local remedies may undermine

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135 *See* RUDOLF DOLZER & CHRISTOPHER SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 215 (1st ed. 2008).

the investor's ability to prove a treaty breach when the state had not finalized its measures.[136] Using such a defense claim by the state successfully would require the state be committed to the commission's decisions as well as settle the claims in a reasonable period of time, otherwise the defense is not valid. If the state is able to raise such claims, an investor would likely prefer to cooperate with the commission to avoid such a risk. Such a commission has additional advantages, which may also encourage investors to cooperate. First, investors and states usually have a long-term relationship. States would still need foreign investors in their markets and investors would still be interested in preserving their investments and recovering their losses. A semi-formal dispute settlement mechanism is a friendlier venue for settling disputes than filing an international claim with ICSID.[137] Second, investors that confront a state undergoing an economic crisis face uncertainty with regards to the ability to enforce any award. As the experience in Argentina shows, it took almost ten years for Argentina to comply with those awards.[138]

Both the U.S. Model BIT (2014) and the Canadian Model BIT (2004), include a provision for a tribunal consisting of economic experts that can review the state defense with regards to financial measures. The U.S. Model BIT explicitly excludes financial measures taken for insuring the stability of the financial system from the obligations of the treaty as long as they are not used as a means of avoiding those obligations.[139] In addition, it also excludes financial measures concerning currency exchange from the treaty. Where a state claims that a contested measure falls within those exclusions, it must inform the competent financial authorities in both states and request they jointly determine this matter. In the case those authorities fail to reach a joint statement, the tribunal would be constituted with economic experts or legal professionals.[140] In the Canadian Model BIT, a similar provision states that the treaty does not prevent a party from adopting prudential measures necessary to maintain essential interests, such as the safety of financial institutions and the stability of its financial system. If a case raises such a defense then

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136 *See id*.

137 Nancy Welsh & Andrea Kupfer Schenider, *The Thoughtful Integration of Mediation into Bilateral Investment Treaty Arbitration*, 18 HARV. NEGOT. L. REV. 71, 77 (2013).

138 Moshe Hirsch, *Explaining Compliance and Non-Compliance with ICSID Awards: The Argentine Case Study and a Multiple Theoretical Approach*, 19 J. INT'L ECON. L., 681, 682-701 (2016)

139 U.S. Dep't of State, Bureau of Economic and Business Affairs, H.R. and Lab., U.S. Model Bilateral Investment Treaty art. 20 (2012).

140 *See id.* art. 20(3)(c), at 22–23.

the parties to the agreement should seek a mutual report on whether such defense is valid[141]

Those suggestions, however, along with the prolonging proceedings, do not change the framework for settling the disputes. They only shift the authority to decide the economic aspects of necessity to an expert tribunal, while the dichotomy between liability and damages, followed by the application of private law methods for assessment of damages, remains the same. Thus, we find this suggestion only partially addresses the considerations in moments of economic crises, namely, the difficulty to decide on economic issues.

A fund allocation instrument has its own drawbacks though. First, it demands the state decide remedies immediately after it has decided the measures. On the one hand, a state needs to first stabilize the economy to be able to decide how much funds to allocate, who will receive this allocation, and how recipients will be paid. On the other hand, a state should decide compensation in a reasonable time, otherwise the instrument is inefficient. Second, it requires a state be bound to a compensation offer while the investor still has an option to resort to alternative dispute settlement mechanisms. Requiring an investor to waive its rights to resort to international tribunals will probably be useless—as investors would prefer international tribunals—and undermines any future claims regarding the exclusion of local remedies. Indeed, the tribunal in BG Group Plc. v. Argentina decided that Argentina's refusal to negotiate with investors who choose to resort to courts or international tribunals renders the requirement to exhaust local remedies meaningless.[142]

However, if a state is able to establish such a commission efficiently, then it would have more control on the allocation of funds and the total amount of damages to be paid, which will increase certainty. As we saw in the cases of *LG&E* and *Enron*, uncertainty involves the assessment of damages and no tribunal considers the accumulative amount of damages. A state may use this uncertainty to its own benefit; if a state is able to establish an alternative method of compensation that is based on reasonable justifications, then such policy will be more difficult for investors to challenge at a later stage in an investment tribunal, and tribunals would enjoy less discretion. In other words, a state precautionary measure from investment treaty claims will set a higher threshold for investors to prove breach of a treaty.

141 *See id.* art. 17, at 19.

142 *See* BG Group Plc. v. Rep. of Arg., Case No. 008-0485, Final Award, ¶¶ 140–55 (Arb. Trib. 2007), https://www.italaw.com/sites/default/files/case-documents/ita0081.pdf.

V. SUMMARY

Analyzing the current options facing states and investors during an economic crisis shows that a private law analogy plays a dominant role in allocating costs between foreign investors and states. This is due to the fact that investment treaty claims focus on the relation between the state and the investors notwithstanding the economic background on which their relationship was initially established and which later erupted due to an extreme change in that background. In such an approach, mechanisms for managing claims are analogous to private law, whether contract law or tort law, of which once a wrongful act is committed the state pays the costs to the investor as if the wrongful act was not committed. But to evaluate the costs in such case, it should be assumed that the economic crisis, to some extent, did not occur, that the state is capable of carrying its obligation, and that the actions taken by the state to recover from the crisis do not concern the investor. Such an approach may be justified if we follow the traditional economic analysis, assuming the state and the investor are private individuals in the global market. But this assumption stands neither to the state being susceptible to changes in the global market nor to the investor enjoying the economic policy taken by the state before the crisis—and, to some extent—benefitting from its actions after the crisis.

Economic crisis, as any disaster with mass damages, requires specifically tailored mechanisms that consider the need to allocate damages between the state and individuals. States developed models for regulating the compensation of victims in mass disasters or crises. Foreign investor claims are mass as well if we consider the amount of damage caused to those investors. The massive amount of damages that involves foreign investors in economic crises, as the cases in Argentina and Cyprus suggest, requires states to consider appropriate models for compensating investors or securing damages.

We have examined three models for compensating foreign investors for costs incurred by state emergency measures in an economic crisis. Investment treaty arbitration, as it is designed and applied today, appears the least preferable option for reparations in the times of economic crisis. Its system of remedies is based on private law remedies that separate liability and damages while only considering the relationship between the two litigating parties. Mandatory insurance and fund allocation via commission, however, are more appropriate models. They both offer a distribution of costs between the investor and the state, allow a wider range of relevant considerations in those unique circumstances, and maintain amicable relations between the state and investor. While

insurance is an ex-ante model, a commission serves as an ex-post model when insurance is not available. As such, they complement each other and offer an alternative to investment treaty arbitration. Those mechanisms can be incorporated in treaties or applied ad hoc by states and investors. In any case, neither the risk of suffering from an economic crisis nor the risk of suit from foreign investors should be ignored by states.