

Transnational Investment Arbitration: Proportionality's New Frontier

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The arbitral world is at a crucial point in its historical development, poised between two conflicting conceptions of its nature, purpose, and legitimacy. The larger questions addressed in this paper are revealing. To what extent are arbitrators agents of contracting parties, and to what extent are they agents of a larger global community? Should ICSID, or any other arbitration house that claims to offer effective resolution of contractual disputes, resist its own judicialization? Or is judicialization, and the consequent accretion of arbitral “governance,” now inevitable? Should, or must, arbitrators balance the rights of investors against public goods, such as the protection of health, the environment, and other human rights when they assess State measures that are allegedly expropriatory, and when fashion remedies? Does balancing imply adopting a proportionality principle?

In this paper, I address these questions from the standpoint of delegation theory.¹ In Part I introduces the basic “Principal-Agent” framework [P-A] used by social scientists to explain why actors create new institutions, and briefly discusses how P-A has been applied to the study of courts. In Part II, I use delegation theory to frame a response to the questions just posed. The arbitral world, I argue, faces a choice between two models of its own structure and function, indeed, its very identity. In Part III, the focus is on the judicialization of investment arbitration. In particular, I consider the extent to which it can be argued that the International Center for the Settlement of Investment Disputes (ICSID) is developing in a judicial, perhaps even constitutional, direction. Judicialization is an essential background condition for the present flirtation with proportionality. In part 4, I examine some of the ways in which arbitrators are using, or are likely to use, PA.

Two caveats deserve mention in advance. First, my objectives are theoretical and explanatory: I seek to provide an account of the current state of affairs from the perspective of delegation theory. This account can be read through normative lenses – readers may support or oppose judicialization, for example – but the paper takes no stand here on the various normative issues raised. Second, this chapter does not constitute a claim that delegation theory is superior to other analytical frameworks, or that it should replace other methods of proceeding. Instead, I hope that readers will ask themselves whether this account even deserves a place in the field.²

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¹ This paper follows from Alec Stone Sweet & Jud Mathews, *Proportionality Balancing and Global Constitutionalism*, 47 COLUM. J. OF TRANSNAT'L L. (forthcoming Fall 2008). In that paper, I sought to explain why judges in diverse contexts might be attracted to proportionality analysis (PA), and then described and assessed the various processes through which the framework emerged, institutionalized, and diffused.

² Delegation theory is largely unknown in the scholarly discourse on transnational investment arbitration. In my view, the P-A framework is only of value to the extent that it both (1) clarifies theoretically-relevant questions, and (2) stimulates research on these questions.

I Principals and Agents

Over the past three decades, P-A emerged as a standard approach to research on institutions as diverse as the firm,³ State organs,⁴ and international regimes.⁵ In Economics, it is the dominant paradigm for analyzing problems of corporate governance and industrial organization; in Political Science, it is associated with “rational choice” approaches to government. Although scholars use it for varied purposes, P-A is popular for three main reasons. First, it explains the origin and persistence of institutions – or modes of governance,⁶ if one prefers – in light of the specific functional demands of actors who need governance. Second, it offers ready-made, appropriate concepts that the analyst can adapt easily to virtually any governance situation. Third, it helps to organize empirical research on the dynamics of delegated governance, allowing the analyst to derive testable propositions about the consequences, *ex post*, of delegating in a particular form, *ex ante*. I outline a highly simplified version of the framework here, highlighting relevant features that are agreed-upon among scholars who use it, and apply it to courts.

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

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

- (1) resolve commitment problems: as when the Agent is expected to work to

³ Jean-Jacques Laffont & David Martimort, *The Theory of Incentives: The Principal-Agent Model* (Princeton: Princeton University Press, 2001); P. Milgrom and J. Roberts, *Economics, Organization, and Management* (Englewood Cliffs: Prentice Hall, 1992).

⁴ E.g., K. Strom, W. Müller, and T. Bergman (eds.), *Delegation and Accountability in Parliamentary Democracies* (Oxford: Oxford University Press, 2004).

⁵ E.g., Mark Pollack, *The Engines of European Integration: Delegation, Agency, and Agenda-Setting in the EU* (Oxford: Oxford University Press, 2003); Jonas Tallberg, “Delegation to Supranational Institutions: Why, How, and with What Consequences?” 25 *West European Politics* (2002), pp. 23-46; A. Stone Sweet, *The Judicial Construction of Europe* (Oxford: Oxford University Press), chs. 1, 3, 4.

⁶ I define governance as “the process through which the rule systems in place in any social setting are adapted to the needs and purposes of those who live under them,” Alec Stone Sweet, “Judicialization and the Construction of Governance”, 32 *Comparative Political Studies* (April 1999), p.147.

enhance the credibility of promises made either between Principals, or between Principals and their constituents, given underlying collective action problems;

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

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

(4) avoid taking blame for unpopular policies: as when the Principals command their Agent to maximize specific policy goals that they know may sometimes be unpopular with important societal actors and groups.⁷

These logics will often overlap one another.

The Principals' capacity to control the Agent is a central preoccupation of the approach, bordering on obsession. The rationalist assumes that any Agent may have, or will develop over time, its own interests, and these will at times diverge from those of the Principals. To the extent that the Agent performs its appointed tasks in ways that were unforeseen and unwanted by the Principals, the Agent will undermine the social legitimacy of delegation (which is based on the *ex ante* preferences of Principals), while producing unwanted policy that may be costly to eradicate. These losses – which I will call “agency costs” – inhere in the delegation of discretion. Principals thus face a dilemma. In order for them to reap the benefits of delegation, they have to grant meaningful discretionary power to an Agent; but the Agent may act in ways that undermine the logic of delegating in the first place.⁸

The analyst assumes that Principals share this anxiety. Principals will therefore seek to incentivize the Agent's work in order to maximize benefits while limiting agency costs. In designing and reforming an institution, the Principals choose from a complex menu of options. Principals may give an Agent more or less authority to govern in a specific domain *ex ante*; they may create procedures enabling them to monitor the Agent's decisions; and they may choose to retain some or no power to undo an Agent's decisions *ex post*. This point can be formalized. Any Agent's “zone of discretion”⁹ is constituted by (1) the sum of delegated powers (discretion to take authoritative decisions) granted to the Agent, minus (2) the sum of control instruments, available for use by the Principals to constrain the Agent, or overturn its decisions.

The zone of discretion can be defined and assessed without regard to the Principals' preferences and policy goals. Nonetheless, one expects such preferences to be fundamental to the choices made. If the Principals, for example, seek to bind their

⁷ Based on M. Thatcher and A. Stone Sweet, “Theory and Practice of Delegation to Non-Majoritarian Institutions,” 25 *West European Politics* (2002), p. 4.

⁸ In some situations, the expected return to delegating to the Agent will be inversely proportional to limitations placed on the Agent's discretion. Principals, after all, can choose to govern themselves, without the help of an Agent.

⁹ Based on Thatcher and Stone Sweet, “Theory and Practice of Delegation to Non-Majoritarian Institutions,” *op. cit.*, pp. 5-6.

successors to a policy of low inflation, they may decide to create an independent Central Bank, with plenary powers over macro-economic policy, while insulating the Bank's decision from interference by present and future elected officials. To take another example, if Principals are uncertain about the kind of policy they want, say, in a regulatory domain characterized by technical complexity and scientific risk, they may give an Agent the task of developing a regulatory framework as problems emerge and evolve, while retaining effective *ex post* controls. Generally, the more Principals seek to pre-commit themselves to specific outcomes or values, the more discretion they will delegate to an agent, and the weaker will be *ex post* mechanisms of control. In contrast, the more principals seek a rich range of policy alternatives from which to select, on an ongoing basis, the more they will reources they will devote to monitoring the Agent's activities, and the more effective will be the *ex post* mechanisms of control.

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

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

I now depart somewhat from the classic P-A framework. In my view, the framework loses much of its relevance when applied to certain types of Agents, in

particular, those whose decision-making is insulated, as a legal or practical matter, from *ex post* controls. I prefer to apply a model of “trusteeship” to situations wherein the Principals have conferred expansive, open-ended “fiduciary” powers on an Agent.¹⁰ A trustee is a particular kind of Agent, one that possesses authority over those who have delegated in the first place. Note that the judge, in the system of legislative sovereignty, does not govern the Parliament; he is an Agent of the Parliament’s will as expressed in statutory commands. Constitutional courts are trustee courts. They typically exercise fiduciary responsibilities with respect to the constitution; in most settings, they do so in the name of a fictitious entity: the sovereign People. The political parties in Parliament are never Principals, with respect to the judge of the constitution, but are themselves subject to the constitutional law, as interpreted by the constitutional judge.

Mapping out a court’s zone of discretion does not tell us how the court will actually use its powers. Some predictions are nonetheless implied. Other things equal – though conditions and context are rarely equivalent – the wider a court’s zone of discretion, the more likely it will be that it will come to dominate the evolution of the system as a whole. We can expect a Trustee court to do so in so far as three conditions are met. First, the court must have a case load. If actors never bring cases to the court, it will accrete no influence over the system. Second, once activated, judges must resolve these disputes and *give defensible reasons* in justification of their decisions. If they do, one output of adjudication will be the production of a case law, or *jurisprudence*, which is a record of how the judges have interpreted and applied the law. Third, those who are governed by the law must accept that meaning is (at least partly) constructed through this jurisprudence, and they must use or refer to relevant case law in future disputes. None of these conditions can be taken for granted as naturally occurring; they are, rather, part of a process called *judicialization*.¹¹

The next section applies these ideas to transnational arbitration.

II Judicialization and Constitutionalization

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

¹⁰ See Alec Stone Sweet, “Constitutional Courts and Parliamentary Democracy,” 25W. EUR. POL. 77 (2002), building on the contributions of Giandomenico Majone, *Two Logics of Delegation: Agency and Fiduciary Relations in EU Governance*, 2 EUR. UNION POL. 103 (2001), and Terry Moe, *Political Institutions: The Neglected Side of the Story*, 6 J. L. ECON & ORG. 213 (1990).

¹¹ A. Stone Sweet, “Judicialization and the Construction of Governance,” *op cit*.

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

A P-A relationship is constituted when two contracting parties (the Principals) confer upon an arbitrator (the Agent) the authority to resolve any dispute that arises under the contract. The Principles are also free to select the law governing the contract and the procedures to be used in the dispute settlement process, which are assumed to constrain the arbitrator. To be sure, arbitration has been steadily institutionalized over the past five decades. Rules and procedures have been substantially codified by the major arbitration houses;¹² it is now settled doctrine that arbitral clauses are separable from the main contract¹³; in many parts of the world, the scope of judicial review of arbitral awards has been radically reduced¹⁴; and issues of *Kompetenz-Kompetenz* have been largely resolved in the arbitrator's favor.¹⁵ But these developments can be said to push in the same direction: to enhance the Agent's authority to enforce the parties' commitments, in the face of a party's tempted to renege, once a contractual dispute erupts.

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

A second type of model would accept as given most of the precepts and logics of the first model, but would reject the view that the arbitrator is merely the Agent of the contracting parties. Instead, the analyst adds a level of law and institutional complexity to the equation in order to show that the arbitrator can be meaningfully conceptualized as an Agent of the transnational commercial and investment community. Consider the case of transnational commercial arbitration in which the parties to the contract are both private firms. The parties have delegated to the arbitrator, thus constituting a standard,

¹² All established arbitration houses have published rules that are mandatory for those who choose to use their services.

¹³ That is, the validity of the arbitral clause is not affected by the legal nullity of the contract of which it is a part. In essence, the doctrine forecloses moves by one of the parties to the contract to avoid arbitration by pleading the contract's nullity.

¹⁴ That is, the legal validity of arbitral awards, and thus their enforceability in national law, is presumed.

¹⁵ *Kompetenz-Kompetenz* refers to the formal competence of a jurisdiction to determine its own jurisdiction, or the jurisdiction of another organ. Modern arbitration statutes and case law largely accept that the arbitrator possesses the authority to fix the scope of its own jurisdiction, subject of course to the will of the contracting parties.

contract-based P-A relationship. But, I would insist, this act of delegation does not take place in a vacuum, or in anarchy, but in the context of an increasingly elaborate legal system.

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

If the arbitrator is not merely the Agent of two contracting Principals, but an Agent of the greater community, then one might ask if (or assume that) the arbitrator has a responsibility to take into account the community's interests in decisions. There exists a great deal of evidence showing that this is what is in fact happening. More and more decisions are being published, and certain kinds of decisions are treated by subsequent litigators as having precedential value.¹⁶ Scholars refer to the emergence of an "arbitral common law," tailored to the needs of specific categories of traders, built as the common law has traditionally been built, through reasons given that subsequently congeal as precedent.¹⁷ Not surprisingly, the question of whether the creation of appellate instances for the arbitral system is being actively debated.¹⁸ Each of the major arbitral tribunals requires that arbitrators give reasons for decisions; and each has developed mechanisms for reviewing these reasons prior to approving awards. In short, arbitrators are becoming – if with some hand-wringing and reluctance – more like courts.¹⁹

Thus, in contrast to the first model, the second type of model does not assume that arbitrators only make law that is retrospective and particular, or encompassed entirely in the contract. Arbitrators can and should be involved in lawmaking that is also general and prospective. Whereas proponents of the first model must worry that such lawmaking would undermine the legitimacy of the Agent, advocates of the second model believe that

¹⁶ K. Berger, *The Creeping Codification of the Lex Mercatoria* (The Hague: Kluwer, 1999), pp. 57–74, 214–20.

¹⁷ T. Carbonneau, *Lex Mercatoria and Arbitration: A Discussion of the New Law Merchant* (Yonkers: Juris, 1997), pp. 16–18.

¹⁸ See part III of this chapter.

¹⁹ Florian Grisel, "Control of Awards and Re-centralisation of International Commercial Arbitration", *Civil Justice Quarterly*, Vol.25, March 2006, p.166; A. Stone Sweet, "The New *Lex Mercatoria* and Transnational Governance," 13 *Journal of European Public Policy* (2006) pp. 641–43.

the social legitimacy of arbitration is inextricably tied to the question of how arbitrators deal with various problems faced by the community, including larger issues of systemic legitimacy. It is telling that the insistence on giving reasons, the accretion of precedent, and calls for supervisory or appellate review, are justified in the name of “justice.” The major houses are keenly aware that the legitimacy and viability of arbitration will heavily depend upon their capacities to provide a modicum of legal certainty (justice) for both present *and* future users of the system.

I now turn to the main topic of the paper, transnational investment arbitration, wherein one party to the arbitration is a State. The standard conception of investment arbitration closely resembles that of *inter partes* commercial arbitration (essentially my first model). Investment arbitral tribunals are established on an *ad hoc* basis, and their mandate is specifically limited to the settlement of the disputes that have been submitted to them. Tribunals take authoritative decisions whose reach is limited to the parties. Proponents of the first model must find a way to integrate public sources of law into their analysis of investor-state arbitration, but it is not easy to see how they can save the model. In my view, the first model is doomed, to the extent that the judicialization process proceeds.²⁰

Finally, some scholars have taken a further step, asking whether investor-state arbitration has been, or is being, “constitutionalized.”²¹ There are a number of ways in which investment arbitration may be said to be *constitutional*. First, the ICSID is a global institution that governs by virtue of, and with reference to, constituting law that has been ratified by more than 140 sovereign States. The ICSID Convention, Regulations and Rules comprise that constitution, and the scope of the Center’s authority is unrivalled in its domain of activity. Most stable, Treaty-based organizations would probably be considered constitutional under this definition.²²

The second, forcefully advocated by, among others, Ulrich Petersmann, takes a systemic perspective. This view acknowledges that the system is not constitutional according to standard ways of thinking drawn from national systems, in so far as there is no unified sovereign in the system, and there is no agreed-upon hierarchy of norms that securely integrates international and national legal orders. In a phrase, the system remains pluralistic. Nonetheless, proponents of this perspective seek to identify those elements that can be characterized as “constitutional,” and then argue that these elements deserve to be given special status in transnational and international legal process. The

²⁰ It deserves mention that the ICSID has always been considered to be more of a “court” than an “arbitral body” in the classic sense. Barton Legum, “La Réforme du CIRDI : Vers une Juridictionnalisation de l’Arbitrage Transnational?,” in Ferhat Horchani (ed.), *Où va le droit de l’investissement ? Désordre normatif et recherche d’équilibre*, Paris, Pédone, 2006, p.283.

²¹ See the volume - P.M. Dupuy, F. Francioni, U. Petersmann (eds.), *Human Rights, International Investment Law, and Investor-State Arbitration* (Oxford: Oxford University Press, forthcoming 2009) – which is organized around this issue; in particular the chapter by U. Petersmann, “Constitutional Theories of International Economic Adjudication and Investor-State Arbitration.”

²² That is, the organization was constituted by a founding document and the legal system is organized by what H.L.A. called “secondary rules.” H.L.A. HART, *THE CONCEPT OF LAW* 92-93 (2d ed. 1994), pp. 94, 114.

most commonly invoked elements are *jus cogens* norms, basic human rights, and procedural guarantees associated with due process and access to justice.²³ What is being argued is that these norms constitute an overarching frame, a theoretically-supposed “constitution,” within which one finds discrete hierarchies, both national and Treaty-based. These systems interact with one another pluralistically, with reference to the frame. One then focuses on the dynamics of pluralist interaction – on inter-regime conflict, resistance, diplomacy, and cooperation – to find evidence that the system is indeed constitutional, and to identify mechanisms of systemic construction.²⁴

In this account, the arbitrator as Agent, and the ICSID arbitrator in particular, is bound to interpret and apply these norms when they are material to any arbitral proceeding. The duty flows from the very fact that these norms are constitutional. And it is supplemented and reinforced by other norms, such as the call in the Preamble of the Vienna Convention on the Law of Treaties that disputes be resolved “in conformity with the principles of justice.” Following this line of argument, the ICSID arbitrator is an Agent of the contracting parties, an Agent of the investment community and, at least at times, an Agent of the global legal (constitutional) order.

III The Case of the ICSID

I have argued (Part I) that the wider is a court’s zone of discretion, the more likely it will dominate the evolution of the system as a whole, through its case law. Investor-State arbitral tribunals possess a wide zone of discretion. In the ICSID, for instance, arbitral tribunals are the judges of their own competence (article 41 of the ICSID Convention) and have the power to decide on any question of procedure that has not been covered by the ICSID Convention, or the Arbitration Rules, or any rules agreed by the parties (article 44 of the ICSID Convention). At the same time, the parties have limited *ex post* control instruments at their disposal. In the case of the ICSID, parties are pushed into ICSID annulment committees (article 52 of the ICSID Convention), with highly restricted access to challenges of awards in domestic courts (article 54 of the ICSID Convention). Further, the ICSID meets each of the three conditions stipulated at the close of Part I: it has an important and steadily expanding case load; tribunals, who are under a duty to give reasons for their decisions (Article 52(1)(e) of the Rules) have, in fact, built a sophisticated case law; and, today, states and investors argue their cases primarily in terms of this case law, accepting its precedential status.

I have also suggested that judicialization implies a move from the first to the second model of delegation (Part II). I can give empirical content to this claim by identifying specific indicators of judicialization. In this section, I discuss three such indicators: precedent; the admission of *amicus* briefs; and the push for appellate

²³ Although they might object, I read Erica de Wet and Ulrich Petersmann to be representative of this view. See Erica de Wet, *The International Constitutional Order*, 55 INT’L & COMP. L. QUARTERLY 51 (2006); Ulrich Petersmann, *Multilevel Trade Governance Requires Multilevel Constitutionalism*, in CONSTITUTIONALISM, MULTILEVEL TRADE GOVERNANCE AND SOCIAL REGULATION 5 (C. Joerges & U. Petersmann eds., 2006).

²⁴ See also A. Stone Sweet, “Constitutionalism, Legal Pluralism, and International Regimes,” *Indiana Journal of Global Legal Studies* (forthcoming 2009).

supervision of arbitral awards. A fourth – the use of balancing by arbitral tribunals – is the subject of Part IV.

Precedent

Investment arbitral tribunals are engaged in building a *jurisprudence*: a judge-made, precedent-grounded, law of investment arbitration. They are doing so in order to stabilize (potentially explosive) strategic environments, to entrench specific frameworks of argumentation, and to legitimize their own lawmaking.²⁵ Here I focus on ICSID practice.

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

Each tribunal remains sovereign and may retain, as it is confirmed by ICSID practice, a different solution for resolving the same problem; but decisions on jurisdiction dealing with the same or very similar issues may at least indicate some lines of reasoning of real interest; this Tribunal may consider them in order to compare its own position with those already adopted by its predecessors and, if it shares the views already expressed by one or more of these tribunals on a specific point of law, it is free to adopt the same solution.²⁶

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

“The Tribunal considers that it is not bound by previous decisions. At the same time, it is of the opinion that it must pay due consideration to earlier decisions of international tribunals. It believes that, subject to compelling contrary grounds, it has a duty to adopt solutions established in a series of consistent cases. It also believes that, subject to the specifics of a given treaty and of the circumstances of the actual case, *it has a duty to seek to contribute to the harmonious development of investment law and thereby meet the legitimate expectations of the community of States and investors towards certainty of the rule of law.*”²⁷ [emphasis added]

²⁵ M Shapiro and A Stone Sweet, “Judicial Law-Making and Precedent,” in *On Law, Politics and Judicialization* (Oxford: Oxford University Press, 2002), ch. 2.

²⁶ *AES Corporation v. The Argentine Republic* (ICSID Case No. ARB/02/17), Award of 26 April 2005, ¶30.

²⁷ *Saipem S.p.A. v. The People’s Republic of Bangladesh* (ICSID Case No. ARB/05/07), Decision on Jurisdiction and Recommendations on Provisional Measures of 21 March 2007, ¶67. The Tribunal in *Victor Pey Casado et Fondation “Presidente Allende” c. République du Chili* (Affaire CIRDI No. ARB/98/2), Sentence arbitrale du 8 mai 2008, repeated the formula in French, at ¶119.

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

It is today indisputable that “a *de facto* doctrine of precedent”²⁸ governs investor-State arbitration: the parties intensively argue the substance and relevance of prior ICSID rulings, which Tribunals accept as persuasive authority, and then cite as supportive justification for their own rulings.²⁹

Appeal

A third indicator of judicialization is the demand for appellate supervision. Traditional features of arbitration, including the *inter partes* nature of the contract, the *ad hoc* scope of a tribunal's jurisdiction and composition, and the final character of decisions, militate against appeal. The first model of arbitral agency forcefully denies the need for a “vertical system of control”³⁰ of arbitral awards. As a former Chief Justice of the United States has stressed, one important “advantage of arbitration is that [the] process usually need not produce a body of decisional law which will guide lawyers and clients as to what their future conduct ought to be.”³¹ As we have seen, however, ICSID tribunals are behaving more and more like courts, building and using precedent, balancing, and considering wider collective interests of various sorts in their rulings. Cast in the light of the second model of delegation, the issue of appeal is inevitably raised.

Judicial bodies find appeal useful.³² Appeal provides losing parties with cathartic opportunities to defend their interests. And it serves the goal of achieving legal certainty and doctrinal coherence, to the extent that hierarchy and supervision increase the consistency of decisions at first instance. Both may contribute to, or enhance, the overall legitimacy of the system.

In the ICSID context, appeal may be attractive for further reasons. Investor-State arbitration is of huge significance in today's globalized world; the monetary stakes involved are typically high; the good reputations of large multi-national firms and states

²⁸ D. Di Pietro, “The Use of Precedents in ICSID Arbitration: Regularity or Certainty?,” *Int. A.L.R.* (2007), no. 3, p. 96.

²⁹ In 2006, a second sentence was added to Rule 48, which now reads: “The Centre shall not publish the award without the consent of the parties. The Centre shall, however, promptly include in its publications excerpts of the legal reasoning of the Tribunal.”

³⁰ Klaus-Peter Berger, *The Creeping Codification of the Lex Mercatoria* (Alphen aan den Rijn: Kluwer Law International, 1999), p.73.

³¹ William Rehnquist, “A Jurist's View of Arbitration” (1977) 32 *Arb. J.*1, p.5.

³² Martin Shapiro, “Appeal,” 14 *Law & Society Review* 629 (1980), p.631.

are at risk; and important disputes will always involve significant social interests. It may be, as a renowned practitioner has argued, that the investment community needs courageous arbitrators who are willing to think and to make law creatively, in the interest of the community, and in light of social and economic change. “Brave judges “will inevitably make mistakes,” Van Vechten Veeder writes, and, given the inevitability of mistakes, “[one] needs an appellate system.”³³

As judicialization proceeds, the demand for appeal will grow. At present, there is no shortage of proposals on the table, three of which deserves mention. A first consists in the creation of a standing court of appeal, an “*ICSID Appeals Facility*”,³⁴ or a chamber of the International Court of Justice acting as a “*Supreme Investment Court*”.³⁵ A second aims at building on existing arrangements, modeling an appellate jurisdiction on the *ICSID ad hoc* annulment committees.³⁶ A third proposal would create a permanent body that would answer preliminary questions raised on an issue-by-issue basis by arbitrators, as the European Court of Justice does under Article 234 of the Rome Treaty.³⁷

Third Party Participation

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

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

“[I]t is the Tribunal’s unanimous opinion that [requests to submit *amici* briefs] are beyond the power or authority of the Tribunal to grant. The interplay of the two treaties involved [...] and the consensual nature of arbitration [locates] the control of [this] issue ... with the parties, not the Tribunal. [T]he Tribunal ... does not, absent the agreement of the Parties, have the power to join a non-party to the proceedings; to provide access to hearings to non-parties and, *a fortiori*, to the public generally; or to make the documents of the proceedings public.”³⁸

³³ Van Vechten Veeder, “The Necessary Safeguards of an Appellate System,” 2 *Transnational Dispute Management* (April 2005), p.7.

³⁴ ICSID Secretariat, “Possible Improvements of the Framework for ICSID Arbitration,” 22 October 2004, pp.14 et seq.

³⁵ A. Qureshi, “An Appellate System in International Investment Arbitration,” in P. Muchlinski, Federico Ortino & Christoph Schreuer (eds.), *The Oxford Handbook of International Investment Law* (Oxford University Press, 2008), pp.1154, 1165 et seq.

³⁶ B. Legum, “The Introduction of an Appellate Mechanism: the U.S. Trade Act of 2002”, in E. Gaillard & Y. Banifatemi (eds.), *Annulment of ICSID Awards* (New York: Juris Publishing, 2004), pp.289, 296-6.

³⁷ Christian J. Tams reviews this and other proposals in “An Appealing Option? The Debate About ICSID Appellate Structure,” *Essays in Transnational Economic Law*, No. 57 (2006).

³⁸ *Aguas del Tunari, SA v. Republic of Bolivia* (ICSID Case No. ARB/02/3), Letter from the President of the Tribunal, 23 January 2003.

In 2006, two tribunals decided otherwise, on the basis of inherent discretion. In *Aguas Argentinas v. Argentine* and *Aguas Provinciales v. Argentine*,³⁹ arbitrators interpreted the last sentence of Article 44 of the Rules – “If any question of procedure arises which is not covered by ... the Arbitration Rules or any rules agreed by the Parties, the tribunal shall decide the question” – as conferring “residual power to the Tribunal to decide” to accept *amicus* briefs or not.⁴⁰ In response, the Rules were amended (new Rule 37 (2)) to confer on tribunals the authority to allow accept such briefs submissions, and to allow external observers to attend hearings (amendment of Rule 32 (2)). Rule 32 (2) was the object of extensive interpretation in an order issued by the *Suez v. Argentina* Tribunal.⁴¹ The order laid down an analytical process, replete with a series of tests, for determining admissibility of *amicus* briefs. Among other things, the Tribunal held that briefs must address issues of substantial “public interest” in a case that involves public goods. As Francioni notes, these changes will enable “the emergence ... of the idea of civil society” in the arbitral world.⁴²

IV. Balancing and Proportionality

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

For sound strategic reasons, investment arbitrators have constructed the “fair and equitable treatment” standard [FETS]⁴³ as a master tool for dealing with investment

³⁹ Article 44 of the ICSID Convention: “[...] If any question of procedure arises which is not covered by this Section or the Arbitration Rules or any rules agreed by the parties, the Tribunal shall decide the question.”

⁴⁰ *Aguas Argentinas, S.A., Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v. The Argentine Republic* (ICSID Case No. ARB/03/19), Order in Response to a Petition for Transparency and Participation as Amicus Curiae, 19 May 2005, ¶10; *Aguas Provinciales de Santa Fe S.A., Suez, Sociedad General de Aguas de Barcelona S.A. and InterAguas Servicios Integrales del Agua S.A v. The Argentine Republic* (ICSID Case No. ARB/03/17), Order in Response to a Petition for Participation as Amicus Curiae, 17 March 2006, ¶11.

⁴¹ *Order in Response to a Petition by Five Non-Governmental Organizations for Permission to Make an Amicus Curiae Submission*, ICSID Case no. ARB/03/19, 12 February 2007 (*Suez* February 2007 order/decision), laying down an analytical process and a series of tests for determining admissibility of *amicus* briefs. Among other things, the Tribunal held that briefs must address issues of substantial “public interest” in a case that involves public goods. For an excellent analysis of this order, see E. Triantafilou, “*Amicus* Submissions in Investor-State Arbitration after *Suez v. Argentina*,” 24 *Arbitration International*, 571-86.

⁴² F. Francioni, “Access to Justice, Denial of Justice, and International Investment Law,” P.M. Dupuy, F. Francioni, U. Petersmann (eds.), *Human Rights, International Investment Law, and Investor-State Arbitration*, op cit..

⁴³ The FETS is found in virtually every Bi-Lateral Investment treaty. The American and Canadian version, found in the Model BIT, provides that: “Each party shall accord at all times to covered instruments fair and equitable treatment, in accordance with customary international law ...” The standard European provision (Dutch, German, Swedish, among others) states that: “Investors and investments of each contracting party shall at all times be accorded fair and equitable treatment in the territory of the other contracting state.”

disputes. Indeed, arbitrators today use the standard as a kind of multi-purpose, umbrella principle that allows them to invoke and apply a wealth of sub-principles, including: good faith; access to justice and due process; regulatory transparency; non-arbitrariness, non-discrimination, and reasonableness; and the legitimate expectations of both parties. Among other functions, the FETS allows arbitrators to consider a wider range of elements than would be normal under the tests for expropriation or regulatory takings (indirect expropriation), as well as to tailor more appropriate remedies.⁴⁴ What is important for my purposes is that the FETS organizes an approach to the kind of disputes in which I am interested here, namely, those involving tensions between (a) an investor's rights (including legitimate expectations in investment security) and (b) the State's legitimate interest in regulating for the public good (including its expectations that investors will be good corporate citizens). Using the FETS in this way pushes tribunals toward balancing.

Balancing pushes arbitrators toward proportionality. Tribunals find balancing attractive because of its scope and flexibility – it allows arbitrators to “see” the entire contextual field and to narrow or expand their intervention as required. Proportionality analysis will determine what the investor and the State can reasonably expect from the other, and what is arbitrary or unfair. Balancing under the FETS also makes it possible for arbitrators to incorporate concerns for third party interests. Thus, Francioni argues that “a progressive interpretation of the FETS ... entails that the investor who seeks equity for the protection of his investment must also be accountable under principles of equity and fairness, toward the host state population affected by the investment.” Arbitrators who take this approach end up balancing the “interests of the investor and the interests of individuals and social groups who seek judicial protection against possible adverse impacts of the investment on their life or their environment,” or human rights⁴⁵ Although the FETS enhances arbitral flexibility, its very elasticity raises anxieties about (a) the scope of arbitral authority – can it ever be constrained at the *ex ante* contractual moment? – and (b) the determinacy of rulings – can arbitrators always get to *any* decision they want? If one accepts that these worries are well-founded, then one can also see why the adoption of proportionality would make sense, in so far as it would inject a measure of analytic, or procedural, determinacy to the balancing exercise. Moreover, proportionality, properly used, requires arbitrators to reduce the losses accruing to the loser as much as is legally possible, thus enhancing their legitimacy.⁴⁶

Proportionality is an analytical framework first developed by administrative and constitutional courts in order to manage legal disputes of a particular structure, the

⁴⁴ Katia Yannaca-Small, “Fair and Equitable Treatment Standard: Recent Developments,” in August Reinisch (ed.), *Standards of Investment Protection*, Oxford, Oxford University Press, 2008, pp. 111-130.

⁴⁵ F. Francioni, “Access to Justice, Denial of Justice, and International Investment Law,” P.M. Dupuy, F. Francioni, U. Petersmann (eds.), *Human Rights, International Investment Law, and Investor-State Arbitration*, op cit.

⁴⁶ This will be so to extent that the ruling is disciplined by Alexy's “law of balancing”: “The greater the degree of non-satisfaction of, or detriment to, one principle, the greater must be the importance of satisfying the other.” ROBERT ALEXY, *A THEORY OF CONSTITUTIONAL RIGHTS* (Julian Rivers trans., Oxford Univ. Press 2002) (1986), p. 102; and p. 47 on principles as “optimization” requirements. See also Stone Sweet & Mathews, *Proportionality Balancing and Global Constitutionalism*, op cit..

paradigmatic example of which concerns a pleaded tension between a right on the one hand, and a constitutionally-recognized public interest pursued by the State, on the other.⁴⁷ In investor-State disputes, a move toward balancing would entail both the recognition of an investor's property rights and a "public interest" defense available to the State. In effect, the parties acknowledge that measures taken by the defendant State have infringed the investor's rights, but that hindrance may nonetheless be mitigated or justified to the extent that the measures taken were not arbitrary, and were meant to serve a proper public good. Arbitrators using the proportionality framework will deploy means-ends testing to evaluate the impact of the State's measures on the investment; they will weigh the investor's rights against the public interest being pleaded; and their conclusions will bear upon their dispositive ruling and remedies.

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

The Tribunal considers that a breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders.⁴⁸

Subsequently, in *Saluka v. Czech Republic* (2006), an UNCITRAL arbitral tribunal referred to the obligation, under the FETS, to balance the interests of the parties:

No investor may reasonably request that the circumstances prevailing at the time the investment is made remain totally unchanged. In order to determine whether frustration of the foreign investor's expectations was justified and reasonable, the host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well. [...] The determination of a breach of Article 3.1 by the Czech Republic therefore requires a weighing of the Claimant's legitimate and reasonable expectations on one hand and the Respondent's legitimate regulatory interests on the other.⁴⁹

Since 2003, ICSID arbitrators have pushed further, explicitly adopting the proportionality principle while citing the European Court of Human Rights (ECHR) and its case law as a source. The ECHR uses, and requires national courts to use, proportionality analysis when it adjudicates the qualified rights found in Articles 8-11 and 14 of the European Convention on Human Rights, and when it deals with the right to property in Protocol No. 1. In the case of *Tecmed v. Mexico*, an ICSID (Additional Facility) tribunal expressly referred to two ECHR rulings in assessing State's actions in

⁴⁷ *Ibid.*

⁴⁸ *S.D. Myers, Inc. v. Government of Canada* (NAFTA Arbitration), Partial Award of 13 November 2000, ¶263.

⁴⁹ *Saluka Investments BV v. The Czech Republic* (UNCITRAL Case), Partial Award of 17 March 2006, ¶¶304-6.

light of the public interest they pursue, then declared that: “There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized in any expropriatory measure.”⁵⁰ In *Azurix v. Argentine* (2006), another tribunal referred to ECHR jurisprudence, *S.D. Meyers*, and *Tecmed v. Mexico*, to justify employing “*the public purpose criterion as an additional criterion to the effect of the measures under consideration [...]*”.⁵¹

In 2006, a new front for proportionality was opened. In four arbitrations involving natural gas transportation and distribution concessions,⁵² Argentina pleaded the “necessity” defense offered by the USA-Argentina Bi-Lateral Investment treaty. Article XI of that Treaty states:

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

Both parties agreed that Article XI should be understood in light of Article 25 of the 2001 *Draft Articles on the Responsibility of States for Internationally Wrongful Acts* (International Law Commission), understood to reflect the state of customary international law. Article 25 reads, *inter alia*:

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

Three tribunals dismissed Argentina’s claim that “necessity” justified the measures under review. Among other things, all three interpreted the “only means” requirement as fatal to the necessity defense if *any other means* were available. All three held that the measures in question were not the only means available, while refusing to identify other means that were available. The tribunal in *LG&E v. Argentine*, however, accepted the defense, but only for a specific “crisis” period (December 2001-April 2003). It did so in the following terms:

“With respect to the power of the State to adopt its policies, it can generally be said that the State has the right to adopt measures having a social or general

⁵⁰ *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States* (ICSID Case No. ARB(AF)/00/02), Award of 29 May 2003, ¶122.

⁵¹ *Azurix Corp. v. The Argentine Republic* (ICSID Case No. ARB/01/12), Award of 14 July 2006, ¶310-312.

⁵² *CMS Transmission Co. v. Argentine Republic*, ICSID Case No. ARB/01/8, Award (May 12, 2005); *LG&E Energy Corp. v. Argentine Republic*, ICSID Case No. Arb/02/1, Decision on Liability (Oct. 3, 2006); *Enron Corp., Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. Arb/01/3, Award (May 22, 2007); *Sempra Energy Int’l v. Argentine Republic*, ICSID Case No. Arb/02/16, Award, P 391, Sept. 28, 2007.

welfare purpose. In such a case, the measure must be accepted without any imposition of liability, except in cases where the State's action is obviously disproportionate to the need being addressed.”⁵³

The Argentina gas cases raise complex interpretive questions that are beyond the scope of this paper. What is important is that arbitrators and scholars are now actively debating whether balancing and the proportionality principle ought to govern how such “necessity” clauses are applied.⁵⁴

[What follows is strictly speculative and may not be defensible.]

Here I will only briefly sketch a case for the use of proportionality, *contra* the arguments made by Jose Alvarez and Katherine Khamsi in their excellent (and epic) analysis of the four 2006 Argentina gas cases. Alvarez and Khamsi argue from a position that holds that BITs are strictly bi-lateral treaties, seemingly without significant multi-lateral consequences.⁵⁵ They are suspicious of calls for appellate review of decisions⁵⁶; they reject the view that ICSID tribunals should ever balance under the Article XI/Article 25 “necessity” clause⁵⁷; and they strongly criticize those who believe that the ICSID should take its inspiration from the case law of the ECHR,⁵⁸ or from the WTO.⁵⁹ Instead, following a demonstration that a restrictive interpretation of Article XI and customary international law is justified by the intent of those who drafted the USA Model

⁵³ *LG&E Energy Corp. LG&E Capital Corp. LG&E International Inc. v. The Argentine Republic* (ICSID Case No. ARB/02/1), *op cit.*, ¶195.

⁵⁴ Compare Alvarez and Khamsi (opposing balancing and proportionality) and Van Harten (supporting a proportionality approach based on the ECHR's case law): J. Alvarez and K. Khamsi, “The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime,” *Yearbook on International Investment Law & Policy* (Oxford: Oxford University Press, forthcoming 2009), who argue that proportionality balancing is inappropriate to investor-State arbitrations, and G. VAN HARTEN, *INVESTMENT TREATY ARBITRATION AND PUBLIC LAW*, at 1-2 (2007), who propose that arbitral tribunals should embrace the proportionality approach developed by the ECHR.

⁵⁵ J. Alvarez and K. Khamsi, “The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime,” *op cit.*, including their concluding comments: “If states want their investment agreements to protect their ‘sovereign’ prerogatives more than they now do or to accord them greater rein, their best route is surely to restrict the scope of investors’ rights or otherwise modify their agreements to so provide – or, to the extent permitted by their terms, to amend their existing BITs. Demanding that arbitrators recalibrate BITs by re-writing them for the state parties is not the best route to legitimizing the investment regime.”

⁵⁶ *Ibid*, pp. 91.

⁵⁷ “Article XI suggests an on/off switch; either a measure is “necessary” for the stipulated reasons or it is not,” *ibid*, p. 65.

⁵⁸ *Ibid*, pp. 66-73, including: “U.S. BITs are narrow tools to correct one particular problem, namely the inability or unwillingness of some states to protect aliens’ rights to their property and to contract. The European human rights system addresses more general deficiencies of democracies and not the rights of alien investors nor the risks of political protectionism as such,” p. 70.

⁵⁹ *Ibid*, pp. 64-66, including: “[W]hile drawing from WTO practice at least has the merits of using a standard that is in use internationally, rather than the law of only one of the BIT parties, there is no particular reason to assume that the drafters of the *U.S.-Argentina BIT* (or U.S. BITs generally) intended to make such a connection to modern WTO law, particularly [given that the necessity] clause was first inserted into the U.S. Model BIT in the early 1980s.” p. 65.

BIT (on which the USA-Argentina was based),⁶⁰ Alvarez and Khamisi support the three tribunals that rejected the necessity defense outright. Finally, although Alvarez and Khamisi take great care to critique a balancing approach to Article XI/Article 25, they do not tell us how the necessity defense could ever be operationalized outside of a external military threat to the State's security.⁶¹ They imply, rather, that Article XI's inherent purpose is to destroy any pleading in favor of a State measure taken for the kinds of public policy considerations PA usually considers.

In contrast, I see three routes that arbitrators might take to get to a proportionality-friendly understanding of the necessity defense under Article 25. The first would be to interpret Article 25 as opening a window onto customary international law more broadly. Customary international law includes various principles of justice, and presumably overlaps with some of the principles covered by the FETS. Alvarez and Khamisi suggest in passing that "some degree of balancing" might be permitted under the cover of the FETS.⁶² It is not clear that Article 25's language of a "grave and imminent peril," read in light of the FETS principle, might not include domestic economic crises when they are accompanied by massive demonstrations and threats of a military coup.

Second, it may be that comparative private law could offer a way in for proportionality. Balancing is a part of the analysis entailed when "necessity" is invoked in American tort actions. In U.S. law, a successful claim of necessity does not eliminate the need to pay actual damages for harm done, though the tortfeasor is usually relieved of the obligation to pay punitive or nominal damages. In German law, section 228 of the BGB provides that a person who damages or destroys another's property acts lawfully, "if the damage or destruction is necessary to protect against the danger [caused by the property] and the damage does not stand out of proportion to the danger." Neither of these provisions are controlling; instead they push judges toward balancing. It bears emphasis that balancing in investor-State arbitrations is not just used to determine State liability, but the extent of liability for the purposes of assessing compensation.

⁶⁰ E.g.: "For the United States, a country that had attempted (with only partial success) to get the UN General Assembly to affirm in 1962 that customary international law (and not only national law) governed the treatment foreign investors received, especially but not only when they were expropriated, and that national courts needed to give way to international arbitration when investors sought that more neutral forum, the negotiation of a BIT afforded it an opportunity to secure, at least bilaterally, such absolute guarantees. As U.S. BIT negotiators in this period have repeatedly indicated, the United States was not about to negotiate these away via treaty or to "balance" investors' rights vis-à-vis the rights of sovereigns. Alvarez and Khamisi, *ibid*, p. 38. "There was presumably no contrary evidence of a distinct Argentine intent (which would presumably be easy for Argentina to acquire) simply because no contrary evidence of intention or object and purpose exists," *ibid*, p. 40.

⁶¹ *Ibid*, pp. 77-78, including: "Accordingly, while we do not take issue with the findings in the Argentine Gas Sector Cases that *in principle* economic crises of a certain catastrophic dimension could pose the kind of internal ("public order") or external threats to the state contemplated by Article XI, we agree with the tribunals in *Enron* and *Sempra* that such an extreme economic crisis would be a rare event and that, given the purposes of the *U.S.-Argentina BIT*, we should not presume that economic crises as such would be embraced by Article XI. We also agree with the CMS, Enron and Sempra tribunals when they suggest that successfully invoking necessity with respect to decisions taken in the economic realm and in respect to what appears to be an economic crisis is exceptionally difficult, if not impossible," p. 77.

⁶² *Ibid*, p. 72.

A third route might be to adapt Article 25's "only way" clause to the standard proportionality framework. Alvarez and Khamsi state that there is no room for a least-restrictive means test (the "necessity" prong in standard PA), and they may be right⁶³ In their view, the "only means" standard stands in opposition to balancing, and it provides virtually no defense for a State not facing extinction by an external threat.

A PA-oriented analysis would, first, rely heavily on the suitability (means-ends) phase of proportionality: that is, the State would have to show that, given the context – crisis! – that the means chosen were rationally connected to the policy objectives. In a state of crisis, of course, the proper means-to-ends connection would entail drastic measures. If measures passed suitability, that is, if the judge determined that the crisis did entail a 'grave and imminent peril,' then she would move to the necessity phase, imposing a least-restrictive means test. The "only means" requirement must pass both suitability and necessity: if the means chosen were not least-restrictive means, they could not have been the only, or necessary, means available.

A final note. Textually, Article 11 of the BIT is relatively hospitable to proportionality, although Article 25's use of the word "only" is less hospitable. It may be that measures could satisfy suitability and least-restrictive means and not, on their face, satisfy the Article 25 "only way" test. If this is the way the standard is interpreted, then proportionality may really control; a more restrictive standard ("only way") does. There may also be a case for equity judges, like arbitrators, to refuse to apply the Article 25 "only way" language literally. What if there were two or more possible ways that the State could safeguard essential interests? Does that mean that *none* of those means should be permitted? Taken strictly literally, this is what Article 25 says; but the result seems absurd. Note that this was the same interpretive conundrum that John Marshall faced in *McCulluch v Maryland* with respect to the American "necessary and proper" clause. Marshall famously resolved it by saying that any suitable means to achieve a constitutional end are permissible. At the very least, we should read the Article 25 language to permit the least restrictive means for the state to safeguard an essential interest.

It would seem that the treaty could reasonably be read to authorize a kind of proportionality analysis when certain boundary conditions are met. The stakes for the state must be high: an essential interest must face a grave and imminent peril. What is precluded here (but which might be permitted in unconstrained proportionality analysis), is the acceptance of a defense pleaded by states who commit *de minimis* treaty violations to protect minor interests. When the stakes are sufficiently high, the suitability and LRM tests might kick in.

Conclusion

In this paper, I have argued that two models of arbitration are in deep tension, and that this tension is gradually being resolved in ways that will make the first model obsolete. Viewed institutionally, arbitrators now preside over the process through which

⁶³ *Ibid*, pp. 64-71.

the rules and principles that govern investor-State relations are elaborated and defended. Our conference focuses on human rights, balancing, and proportionality. The development of investment arbitration is itself a recognition of certain rights, attaching to the investor, including the recognition of property rights, access to justice, due process, and so on. With judicialization, arbitrators increasingly behave as courts do when they deal with these and other rights. Most important, they now find themselves weighing the rights of investors against the public purposes being pursued by States, which may include the various ways that States may act to protect health, the environment, and other basic human rights. They have even begun to use some of the same techniques and procedures that administrative and constitutional judges have evolved in order to enhance legal effectiveness and political legitimacy. These facts, it would seem, deserve wider scholarly attention than they have received.