

**INTERNATIONAL CENTRE FOR SETTLEMENT  
OF INVESTMENT DISPUTES**

WASHINGTON, D.C.

IN THE PROCEEDINGS BETWEEN

LG&E ENERGY CORP.  
LG&E CAPITAL CORP.  
LG&E INTERNATIONAL INC.

(CLAIMANTS)

AND

ARGENTINE REPUBLIC

(RESPONDENT)

ICSID Case N° ARB/02/1

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**DECISION ON LIABILITY**

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*Members of the Tribunal:*

Dr. Tatiana B. de Maekelt, President  
Judge Francisco Rezek, Arbitrator  
Professor Albert Jan van den Berg, Arbitrator

*Secretary of the Tribunal:*

Claudia Frutos-Peterson

Date: 3 October 2006

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Mr. Eric D. Brown  
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and

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*Representing the Respondent*

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Procurador del Tesoro de la Nación  
Procuración del Tesoro de la Nación  
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## TABLE OF CONTENTS

I.	THE PARTIES .....	1
II.	THE ARBITRAL TRIBUNAL.....	2
III.	PROCEDURAL BACKGROUND.....	3
IV.	FACTUAL BACKGROUND.....	10
	A. LATE 1980S AND 1990S .....	10
	B. ECONOMIC CRISIS AND THE EMERGENCE OF THE DISPUTE – 1999-2001 .....	15
	C. THE EMERGENCY LAW – 6 JANUARY 2002 .....	18
	D. RENEGOTIATION OF THE PUBLIC SERVICE CONTRACTS .....	19
	E. REQUEST FOR RELIEF.....	20
V.	PRELIMINARY MATTERS .....	22
	A. JUS STANDI .....	22
	B. LAW APPLICABLE .....	23
	1. Parties’ Positions .....	23
	2. Tribunal’s Analysis.....	24
	3. Tribunal’s Conclusion .....	29
VI.	LIABILITY.....	29
	A. ARTICLE II(2)(A): FAIR AND EQUITABLE TREATMENT.....	29
	1. Parties’ Positions .....	29
	2. Tribunal’s Conclusion Concerning Argentina’s Guarantees to Investors.....	35
	3. Tribunal’s Analysis.....	36
	4. Tribunal’s Conclusion .....	40
	B. ARTICLE II(2)(B): DISCRIMINATORY AND ARBITRARY TREATMENT .....	43
	1. Discriminatory Treatment.....	43
	(i) Parties’ Positions .....	43
	(ii) Tribunal’s Analysis .....	44
	(iii) Tribunal’s Conclusion .....	45
	2. Arbitrary Treatment .....	46
	(i) Parties’ Positions .....	46
	(ii) Tribunal’s Analysis .....	47
	(iii) Tribunal’s Conclusion .....	49
	C. ARTICLE II(2)(C): THE UMBRELLA CLAUSE.....	50
	1. Parties’ Positions .....	50
	2. Tribunal’s Analysis.....	51
	3. Tribunal’s Conclusion .....	53
	D. CONSIDERATIONS ON INDIRECT EXPROPRIATION.....	53
	1. Parties’ Positions .....	53
	2. Tribunal’s Analysis.....	56
	3. Tribunal’s Conclusion .....	60

E.	STATE OF NECESSITY .....	61
1.	Parties' Positions .....	61
2.	General Comments on Article XI .....	61
	(i) Preliminary Considerations .....	61
	(ii) The Question of Whether Article XI is Self-Judging .....	62
	(iii) Necessary Nature of the Measures Adopted.....	64
	a. Parties' Positions .....	64
	b. Tribunal's Analysis .....	67
	(iv) Consequences of the State of Necessity .....	79
	(v) Conclusions of the Tribunal .....	80
VII.	DECISION OF THE TRIBUNAL ON LIABILITY .....	80

## I. THE PARTIES

1. Claimants, LG&E Energy Corp. and LG&E Capital Corp. are corporations created and existing under the laws of the Commonwealth of Kentucky, in the United States of America, with domestic and foreign operations.<sup>1</sup> LG&E International Inc. is a corporation organized and existing under the laws of the State of Delaware, United States of America. Claimants hereinafter will be referred to collectively as “LG&E” or “Claimants.”
2. LG&E has a shareholding interest in three local, gas distributing companies in Argentina created and existing under the laws of Argentina by commandment of the Argentine Government: Distribuidora de Gas del Centro (“Centro”), Distribuidora de Gas Cuyana S.A. (“Cuyana”) and Gas Natural BAN S.A. (“GasBan”), hereinafter collectively referred to as “the licensees”. LG&E owns a controlling equity interest in Centro and minority equity interests in GasBan and Cuyana.
3. Respondent is the Argentine Republic, which along with the United States of America, is a party to the Convention on the Settlement of Investment Disputes between States and Nationals of other States (“ICSID Convention” or “Convention”), ratified by the Argentine Republic in 1994 and by the United States of America in 1966. The Bilateral Investment Treaty between the United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investments was signed on 14 November 1991 (“BIT”, “the Bilateral Treaty” or the “Treaty”) (and entered into force on 20 October 1994).

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<sup>1</sup> Until 1 December 2005, Claimants were LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. However, on 26 January 2006, Claimants informed the Tribunal that the name of two of the companies had been modified: LG&E Energy Corp. is now E.ON.US LLC and LG&E Capital Corp. is now E.ON.US. Capital Corp. LG&E International Inc. kept its name. Upon request by the Tribunal, LG&E submitted documents that, in the Tribunal’s opinion, only prove the change of name but not its effects. Respondent remained silent on this issue.

## II. THE ARBITRAL TRIBUNAL

4. On 31 January 2002 the Centre's Secretary-General registered Claimants' Request for Arbitration in accordance with Article 36(3) of the ICSID Convention. In accordance with Rule 7 of the Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings ("the Institution Rules"), the Secretary-General gave notice to the parties of the registration of Claimants' Request and invited them to constitute an Arbitral Tribunal as soon as possible.
5. Forthwith, the parties agreed that the Arbitral Tribunal should be formed by three arbitrators, one appointed by the Claimants, another by the Argentine Republic and the third one, called to preside over the Tribunal, would be appointed by the Centre's Secretary-General in accordance with the method agreed upon by the parties.
6. On 20 June 2002, the Claimants appointed Professor Albert Jan van den Berg, a national of the Netherlands, as an arbitrator for this case. Said appointment was ratified by the Claimants by letters to the Centre dated 15 and 28 August 2002. The Argentine Republic, by letter dated 26 August 2002, appointed Judge Francisco Rezek, a Brazilian citizen, as an arbitrator. On 7 November 2002, the Centre's Secretary-General, with the parties' agreement, appointed Dr. Tatiana B. de Maekelt, a citizen of Venezuela, as the Arbitral Tribunal's President.
7. On 13 November 2002, the ICSID's Secretariat, in accordance with Rule 6(1) of the Rules of Procedure for Arbitration Proceedings ("Arbitration Rules"), notified the parties that all the arbitrators had accepted their appointments and that the Tribunal was deemed to be constituted and the proceeding deemed to begun as from that date. On this same day, in accordance with Rule 25 of the ICSID Administrative and Financial Regulations, the parties were informed that Dr. Claudia Frutos-Peterson would act as the Tribunal's Secretary.

### III. PROCEDURAL BACKGROUND

8. On 28 December 2001, ICSID received from LG&E a request for arbitration dated 21 December 2001 against the Argentine Republic.
9. By letter dated 24 January 2002 the Claimants filed with ICSID a supplement to their request for arbitration. Claimants asserted that Respondent had committed further violations of the BIT as a result of the enactment by the Government of the Public Emergency and Currency Exchange Law (“Emergency Law”), which allegedly adversely affected Claimants’ investment in Argentina.
10. In accordance with Arbitration Rule 13, the Tribunal held its first session with the parties at the seat of the Centre in Washington D.C. on 19 December 2002. The parties agreed to set the following schedule for the written procedure: Claimants were to file a Memorial on 31 March 2003. Upon receipt of Claimants’ Memorial, Respondent could choose to file an answer within either 60 or 90 days. In its answer, Respondent was entitled to file exceptions on jurisdiction, and to the extent it deemed necessary, could respond to Claimants’ arguments on the merits. In the event that the Respondent filed a Memorial on Jurisdiction, the Claimants were to file their Counter-Memorial on Jurisdiction within 30 days from their receipt of the Respondent’s Memorial on Jurisdiction, followed by Respondent’s Reply on Jurisdiction within 20 days following receipt of Claimants’ Counter-Memorial on Jurisdiction, and Claimants’ Rejoinder on Jurisdiction to be filed 20 days from receipt of the Respondent’s Reply on Jurisdiction.
11. With respect to oral procedure, it was also agreed during the first session to set the following schedule based on the written submissions. In the event that Respondent filed its answer within 60 days and if the Tribunal decided so, there was to be a hearing on jurisdiction between 22 and 23 September 2003. In the event that Respondent filed its answer within 90 days, the hearing on jurisdiction, if the Tribunal were in agreement, was to be held on 20 and 21

October 2003. The hearing on the merits was scheduled for 8 through 12 March 2004.

12. The Claimants filed their Memorial on 31 March 2003.
13. Subsequently, under covenant, the parties decided to amend the schedule of proceedings concerning the objections to jurisdiction. Respondent and Claimants informed the ICSID Secretariat of this amendment on 1 and 2 July 2003, respectively. Under the new schedule, Respondent's Memorial on Jurisdiction was to be filed on 21 July 2003; Claimants' Counter-Memorial on Jurisdiction, on 29 August 2003; Respondent's Reply on Jurisdiction, on 22 September 2003, and Claimants' Rejoinder on Jurisdiction, on 13 October 2003. It was also agreed that the hearing on jurisdiction was to be held on 20 and 21 October 2003, but subsequently, the Tribunal, in joint agreement with the parties, decided that the hearing on jurisdiction should be held between 20 and 21 November 2003, at The Hague, Netherlands.
14. In accordance with the terms set, on 21 July 2003, Respondent formally filed objections to ICSID's jurisdiction. In its Memorial on Jurisdiction, Respondent presented the grounds upon which it based said objections and attached documents in support of its arguments. On 29 August 2003, Claimants filed their Counter-Memorial on Jurisdiction. On 22 September 2003, the Argentine Republic filed its Reply on Jurisdiction, and on 14 October 2003, Claimants filed their Rejoinder on Jurisdiction.
15. On 30 October 2003, Respondent filed a motion to suspend the proceedings and requested, as an alternative measure, a stay of the hearing on jurisdiction. On 31 October 2003, the President of the Tribunal asked Claimants to submit their comments on said motion by 3 November 2003. On 3 November 2003, the Claimants filed an objection to the stay motion. On 5 November 2003, the members of the Arbitral Tribunal deliberated on the Argentine Republic's motion and denied Respondent's motions to suspend these proceedings and stay the hearing on jurisdiction scheduled for



20 and 21 November 2003.

16. The hearing on jurisdiction was held on the date set, at the seat of the Permanent Court of Arbitration in The Hague, the Netherlands. Messrs. Eugene D. Gulland and Oscar M. Garibaldi of the law firm of Covington & Burling from Washington, D.C. acted as counsel for the Claimants. Also present at the hearing were Ms. Dorothy O'Brien, Deputy General Counsel for LG&E Energy Corp. and Mr. S. Bradford Rives, Chief Financial Officer of LG&E Energy Corp.
17. Messrs. Carlos Ignacio Suárez Anzorena and Ignacio Pérez Cortés, on behalf of Dr. Horacio Daniel Rosatti, the then-Procurador del Tesoro de la Nación Argentina, attended the hearing on behalf of the Respondent.
18. During the hearing, the parties presented their arguments on the jurisdictional issues. The Tribunal posed questions to the parties in accordance with Rule 32(3) of the Arbitration Rules.
19. On 30 April 2004, the Tribunal issued its Decision on Objections to Jurisdiction, holding that the present dispute is within the jurisdiction of the Centre and the competence of the Tribunal. In so holding, the Tribunal considered the following criteria:
  - a. That the dispute should be between a Contracting State and a national of another Contracting State and that Claimants should have *jus standi* to act in these proceedings;
  - b. That the issue should be a dispute of a legal nature arising directly from an investment;
  - c. That the parties should have given their consent, in writing, to submit to arbitration and, specifically to the ICSID arbitration; and
  - d. That all the other requirements of both the ICSID Convention and the Bilateral Treaty should be met in order to submit a dispute to arbitration.

20. With respect to criteria (a), regarding *jus standi*, the Tribunal was of the opinion that, for purposes of the ICSID Convention and the Bilateral Treaty, Claimants should be considered foreign investors, even though they did not directly operate the investment in the Argentine Republic, but acted through companies constituted for that purpose in its territory (Decision on Jurisdiction, ¶ 63).
21. With respect to criteria (b), which requires that the issues before the Tribunal be a dispute of a legal nature arising directly from an investment, the Tribunal concluded that, at the jurisdictional phase, it was to be presumed that Claimants' claims were based on alleged breaches of the Bilateral Treaty affecting Claimants' investments within the meaning of the ICSID Convention and the Bilateral Treaty (Decision on Jurisdiction, ¶ 66).
22. With respect to criteria (c), requiring the consent of the parties to submit the dispute to ICSID arbitration, the Tribunal was of the opinion that the Argentine Republic's consent was given through Article VII(4) of the Bilateral Treaty. In turn, when Claimants resorted to ICSID, they decided to submit their investment disputes to the Centre's jurisdiction. It is noteworthy, in this case, that Claimants did not submit the dispute to the Argentine courts or to any other dispute settlement mechanism mentioned in Article VII of the Bilateral Treaty. For this reason, no question regarding the "fork in the road" provision arises in the present case (Decision on Jurisdiction, ¶ 69 *et. seq.*).
23. Finally, with respect to criteria (d), concerning verification of the other requirements of the ICSID Convention and the Bilateral Treaty, the Tribunal concluded that the claims are not time barred, and that the claims asserted in the additional request filed by Claimants are sufficiently sequential to the originally stated claims as to permit their review by this Tribunal for the sake of efficiency. The fact that the license holders may have begun negotiations with Respondent is outside this arbitral proceeding, inasmuch as the license holders, which are different legal entities, are pursuing that process from

their own (corporate) perspective. Thus, in view of the fact that more than six months elapsed from the date on which the dispute arose, i.e. 24 January 2002, there is no bar in initiating the arbitral proceedings (Decision on Jurisdiction, ¶ 80 *et. seq.*).

24. Based on these considerations, the Tribunal:
  - a. Held that the present dispute is within the jurisdiction of the Centre and the competence of the Tribunal;
  - b. Dismissed all of the Respondent's objections as to the admissibility of the dispute and all of the Respondent's objections to the jurisdiction of ICSID and the competence of this Tribunal;
  - c. Ordered, pursuant to Rule 41(4) of the Arbitration Rules, the continuation of the proceeding;
  - d. Reserved all questions concerning the costs and expenses of the Tribunal and the parties for future determination.
25. In accordance with Procedural Order No. 1 dated 4 May 2004, Respondent filed its Counter-Memorial on the merits on 18 June 2004, seeking dismissal of LG&E's claims. On 6 August 2004, Claimants filed their Reply.
26. Respondent filed its Rejoinder on the merits on 27 September 2004, in which it asked the Tribunal, among other legal and factual arguments, to exclude Claimants' witness, Mr. Patricio Perkins, from the hearing on the merits on grounds of an alleged conflict of interest. Claimants objected to Respondent's motion to exclude the witness on 1 November 2004.
27. By means of Procedural Order No. 3, dated 23 November 2004, the Arbitral Tribunal decided (i) to admit the witness depositions offered by Respondent; (ii) to grant Claimants the opportunity to offer additional evidence regarding the witness depositions produced by Respondent in its Rejoinder, at the latest on 20 December 2004 and to cross-examine said witnesses during the hearing on the merits; (iii) to admit the testimony of Mr. Patricio Perkins,

subject to cross-examination by Respondent.

28. In accordance with Procedural Orders Nos. 4 and 5, dated 13 and 18 January 2005, respectively, the hearing on the merits was held between 23 and 29 January 2005, at the seat of the Centre in Washington, D.C. The following persons were present at that hearing:

*Arbitral Tribunal:*

Tatiana B. de Maekelt, President  
Francisco Rezek, Arbitrator  
Albert Jan van den Berg, Arbitrator

*Secretary of the Tribunal:*

Claudia Frutos-Peterson

*Counsel for Claimants:*

Oscar M. Garibaldi (Covington & Burling, Washington, D.C.)  
Eugene D. Gulland (Covington & Burling, Washington, D.C.)  
Eric D. Brown (Covington & Burling, Washington, D.C.)  
Miguel López Forastier (Covington & Burling, Washington, D.C.)  
Karin Kizer (Covington & Burling, Washington, D.C.)  
Warda Henning (Covington & Burling, Washington, D.C.)  
Harris Bor (Covington & Burling, Washington, D.C.)  
Matthew Chester (Covington & Burling, Washington, D.C.)  
Jadranka Poljak (Covington & Burling, Washington, D.C.)  
Alma Ramírez (Covington & Burling, Washington, D.C.)  
Karin Lui (Covington & Burling, Washington, D.C.)  
Horacio Ruiz Moreno (Rosso Alba, Francia & Ruiz Moreno Abogados,  
Buenos Aires, Argentina)  
Leonardo Orlanski (Rosso Alba, Francia & Ruiz Moreno Abogados, Buenos  
Aires, Argentina)

*Also present on behalf of Claimants:*

Dorothy O'Brien (LG&E Energy LLC)

Chris Hermann

Leonardo Massimino

Donaldo Sloog

Gabriel Wilkinson

*Counsel for Respondent:*

Oswaldo Guglielmino (Procurador del Tesoro de la Nación Argentina, Buenos Aires, Argentina)

Gustavo Adolfo Scrinzi (Subprocurador del Tesoro de la Nación Argentina, Buenos Aires, Argentina)

Ana Badillos (Procuración del Tesoro de la Nación Argentina, Buenos Aires, Argentina)

Luz Moglia (Procuración del Tesoro de la Nación Argentina, Buenos Aires, Argentina)

Gabriel Bottini (Procuración del Tesoro de la Nación Argentina, Buenos Aires, Argentina)

Ignacio Pérez Cortés (Procuración del Tesoro de la Nación Argentina, Buenos Aires, Argentina)

Gastón Rosenberg (Procuración del Tesoro de la Nación Argentina, Buenos Aires, Argentina)

*Also present on behalf of Respondent:*

Carlos Garber (Ministerio de Relaciones Exteriores, Comercio Internacional y Culto, Buenos Aires, Argentina)

Alicia Federico (Ente Nacional Regulador del Gas (ENARGAS), Buenos Aires, Argentina)

Charles Joseph Masano (Secretaría de Energía, Buenos Aires, Argentina)

Marcelo Masonni: (Embassy of the Argentine Republic, Washington, D.C.)

*Court Reporters:*

David A. Kasdan

Dante Rinaldi

29. The hearing commenced, as scheduled on Sunday, 23 January 2005 at 8:45 a.m. After a brief introduction by the Tribunal's President, Claimants' counsel, Messrs. Eugene Gulland and Oscar Garibaldi, made their oral presentation to the Tribunal, referring to the arguments indicated in their briefs. They also presented their witnesses for oral examination: Messrs. S. Bradford Rives, Eduardo A. Hurtado, Patricio Carlos Perkins, Rudolf Dolzer, Eduardo Schwartz, Carlos Lapuerta, Antoni Peris Mingot, and Jose E. Álvarez.
30. Thereafter, Messrs. Osvaldo César Guglielmino, Ignacio Pérez Cortés and Gabriel Bottini made their submissions on behalf of the Argentine Republic. The following witnesses testified on behalf of Respondent: Ms. Anne-Marie Slaughter and Messrs. Eduardo A. Ratti, Jorge G. Simeonoff, Cristian Folgar, Nouriel Roubini and Fabián Bello.
31. On 28 February 2005, the parties submitted Post-Hearing Briefs.
32. By letter dated 18 May 2005, the Tribunal informed the parties of its decision to appoint an independent expert to assist the Tribunal in evaluating the expert financial evidence. By letter of 14 September 2005, the ICSID Secretariat transmitted the report on the findings of the independent expert to the parties and invited them to comment on the report by 5 October 2005. The parties filed their observations with the Tribunal on that date.

#### **IV. FACTUAL BACKGROUND**

33. Before considering the merits of the dispute, the Tribunal deems it necessary to set forth the facts that it considered relevant for its decision.

##### **A. LATE 1980S AND 1990S**

34. The present claims are to be viewed against the historic background and

especially the economic upheaval in Argentina and the Government's reaction to the several economic crises suffered by the country in the late 1980s and 1990s.

35. In the late 1980s, Argentina underwent an economic crisis characterized by deep recession and hyperinflation. As part of its economic recovery plan, the Government began an ambitious privatization program with the enactment of the State Reform Law in August 1989. Within this framework, large Government-owned businesses and entities were privatized or granted on concession (Respondent's Counter-Memorial, ¶121).
36. One March 27, 1991, Argentina enacted Law No. 23,928, referred to as the *Convertibility Law*, which ordered the implementation of a fixed exchange rate, pegging the *austral* (the then-Argentine currency) to the United States dollar.<sup>2</sup> The Convertibility Law also banned price or value indexation.
37. One of the primary goals of the Government's plan was the privatization of *Gas del Estado S.E.*, the national natural-gas transport and distribution monopoly. Pursuant to the Government's privatization plan, investors could purchase shares in newly-formed, licensed private corporations that would offer gas transport and distribution services. Such shares were available to domestic and foreign investors.
38. To implement its plan, the Government enacted in June 1992, the *Ley del Gas* ("Gas Law"), which established a comprehensive regulatory structure for the provision of natural-gas transport and distribution services, and created a public agency, called *Ente Nacional Regulador del Gas* (ENARGAS) to oversee the industry.
39. The Gas Law adopted a tariff structure under which ENARGAS would collect tariffs on the price of gas paid by consumers. Under the provisions of

the Gas Law, ENARGAS was required to set the transport and distribution tariffs at fair and reasonable levels that would allow licensed utility providers to recoup a “reasonable rate of return,” after accounting for costs, defined as a rate similar to that applied to activities of similar risk and adequately related to the level of efficiency and satisfactory performance of the transport or distribution service. Profitability was to be measured against other activities of comparable risk.

40. ENARGAS was to set maximum tariffs for a period of five years. At the end of the five-year period, the tariffs were to be reviewed and adjusted based on international market indicators that reflected changes in the value of the goods and services representative of the activities of service providers.
41. The Gas Law was implemented by regulations adopted on 28 September 1992 by Decree No. 1738/92. Pursuant to these regulations, transport and distribution tariffs were to be calculated in U.S. dollars and then expressed in Argentine pesos, and the Government could not rescind or modify the licenses without the consent of the licensees.
42. On 7 December 1992, the Government adopted Decree No. 2255/92, called *Reglas Básicas de la Licencia* (Basic Rules of the License), which supplemented the Gas Law and the above-mentioned regulation and approved prototype licenses for natural-gas transport and distribution. The prototype licenses included a schedule of the maximum tariffs for the first five-year period (1993-1997) of service. The Basic Rules of the License obligated the Government to compensate the licensees fully for any losses resulting from changes to the guaranteed tariff system. The Basic Rules of the License also implemented the semi-annual tariff review based on the U.S. Producer Price Index (“PPI”), to be conducted in January and June of each year (“PPI adjustment”).

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<sup>2</sup> The *austral* later was replaced by the *peso* at the rate of 1,000 *australs* to 1 *peso*.



43. Under this framework comprised of the Gas Law, its regulations and Basic Rules of the License, the five-year review was to be a comprehensive review of the method used to calculate tariffs.
44. By Decree No. 1189/92, published on 17 July 1992, Argentina approved the procedure for the privatization of *Gas del Estado S.E.* It was restructured into two distinct transport business units and eight separate distribution business units, each responsible for a geographic region of the country. Each of the ten business units were transferred to the newly-created companies, which were to operate with a license under the legal framework in force.
45. An international bidding process was set in place by Resolution No. 874/92 issued by the Ministry of Public Works and Services and conducted pursuant to the *Pliego de Bases y Condiciones para la Licitación* (“Bidding Rules”). Under these Bidding Rules, both foreign and domestic investors were free to bid on the shares. The purpose of the Bidding Process was the purchase and sale of the majority interest in each of the licensed companies created by Decree No. 1189/92. Three of those majority interests were sold during that bidding process: 60% of Cuyana’s shares, 70% of GasBan’s shares, and 90% of Centro’s shares.
46. In December 1992, the Argentine Government awarded the contracts for the purchase of the majority of shares in the ten newly-formed licensees into which *Gas del Estado S.E.* had been restructured. The licenses relevant to this dispute were approved by Decrees Nos. 2454/92 for Centro, 2460/92 for GasBan and 2453/92 for Cuyana, and became effective on 22 December 1992.
47. The blocks of shares of Centro, GasBan and Cuyana that were subject to privatization were awarded to private investors: 90% of the shares of Centro were awarded to a consortium formed by *Società Italiana Per Il Gas S.p.A.* (“Italgas”), an Italian company, and *Sideco Americana S.A.*, an Argentine company (“Sideco”); 70% of the shares of GasBan were awarded to a

consortium formed by *Gas Natural SdG S.A.*, a Spanish company, *Compañía General de Combustibles S.A.* and *Manra S.A.*, both Argentine companies; and 60% of the shares of Cuyana were awarded to a consortium formed by Italgas and Sideco.

48. Three Argentine investment companies were created as vehicles for the acquisitions: (i) *Inversora de Gas del Centro S.A.* to acquire the privatized shares of Centro; (ii) *Invergas S.A.* to acquire the privatized shares of GasBan; and (iii) *Inversora de Gas Cuyana S.A.* to acquire the privatized shares of Cuyana. The successful bidders or their affiliates became shareholders of the respective investment companies, which then entered into Transfer Agreements with the Respondent concerning the shares subject to this arbitration.
49. The privatization scheme created by Respondent targeted foreign investors because foreign capital was deemed essential for the successful operation of the Government's economic recovery plan. Foreign investors were encouraged to purchase shares with guarantees, such as tariffs calculated in U.S. dollars, automatic and periodic adjustments to the tariffs based on the PPI, a clear legal framework that could not be unilaterally modified, and the granting of "licenses" instead of "concessions" with a view to offering the highest degree of protection to prospective investors.
50. As part of its marketing efforts, Argentina distributed an Information Memorandum in foreign markets, including the United States and Europe. The Information Memorandum summarized the legal framework governing the privatization, the terms and conditions for the bidding, the bidding process and the legal and the regulatory framework that would apply to the new industry after privatization. The information in the memorandum concerning the privatization, prepared and distributed by investment banks, contained descriptive information and included disclaimers to discourage investors from relying solely on the information therein.

51. During this period, Argentina undertook to provide enhanced legal protection to investors so as to attract foreign investment in support of its privatization scheme. The Respondent ratified several treaties relating to international investment obligations, such as the ICSID Convention and a great number of bilateral investment treaties, including the Argentina-U.S. Bilateral Investment Treaty at issue in this dispute. As mentioned above, the Convertibility Law, which pegged the peso to the U.S. dollar, was also enacted at this time.
52. In reliance on the legal guarantees offered by the Argentine Government for the privatized energy industry, and based on its positive prior experience investing in the privatized Argentine gas market in 1992, Claimants chose to purchase shares of three licensed companies in the gas-distribution market. In February 1997, LG&E purchased a 45.9% interest in Centro and a 14.4% interest in Cuyana. In March 1999, LG&E purchased a 19.6% interest in GasBan.
53. From 1993 until the end of 1999, Claimants agree that the gas-distribution licensees and Respondent abided by their respective obligations under the licenses and law governing the privatization scheme. According to Claimants, the licensees invested heavily in Argentina's natural-gas-distribution infrastructure. GasBan invested about US\$372 million in a new plant and equipment, even though originally required to invest US\$90.9 million; Centro invested US\$92 million, although originally required to invest US\$10 million; and Cuyana invested more than US\$120 million, although originally required to invest US\$10 million. In return, Argentina honored the provisions of the licenses and other legal obligations, including the semi-annual tariff adjustment under the PPI indicator, and calculation of the tariffs in U.S. dollars.

## **B. ECONOMIC CRISIS AND THE EMERGENCE OF THE DISPUTE – 1999-2001**

54. A new economic crisis developed in Argentina in the late 1990s. In the third

quarter of 1998, the Argentine economy plunged into a period of recession that was to last four years and triggered, in Respondent's opinion, the worst economic crisis since Argentina's inception in 1810 (Respondent's Counter-Memorial, ¶ 782).

55. In 1999, Argentina's Gross Domestic Product ("GDP") decreased causing a dramatic fall in domestic prices. Private consumption and investments began falling in August 1998 and Argentina entered a deflationary period. The period was marked by widespread decline in the value of assets located in Argentina. By the end of the 1990s, many economists considered the peso as overvalued, and predicted that the currency board would have to be abandoned, which would inevitably devalue the peso. Argentina's country risk premium increased, gradually excluding the country from the international credit market. These economic indicators were accompanied by social problems –unemployment, poverty and indigence levels began to increase. On 10 December 1999, Mr. Fernando de la Rúa took office as the President of Argentina. His administration tried to maintain the peg of the Argentine peso to the U.S. dollar as mandated by the Convertibility Law.
56. Against this background, public services rates, as specified in the contracts, were due to be adjusted in January 2000 based on the PPI. At the time, the United States was experiencing a high inflationary period, while Argentina was experiencing a significant deflationary period. As established in the Gas Law, the tariffs were to be adjusted to reflect changes in the cost structure of utility providers (Gas Law, Article 41). Argentina considered that the pending tariff adjustments based on the U.S. rate were unreasonable because they would result in a significant increase in utility rates within a recessionary and deflationary context.
57. Argentina met with the gas-distribution licensees to discuss a temporary suspension of the semi-annual tariff adjustments. Two agreements that the Government and the licensees entered in 2000 formed part of Claimants' original claim submitted to this arbitration.

58. On 6 January 2000, the Government and the licensees entered an agreement (*Acta Acuerdo*) whereby the licensees agreed to a one-time, six-month postponement of the tariff adjustment due in January 2000. Pursuant to the agreement, the tariffs would be recovered with interest from 1 July 2000 to 30 April 2001. Therefore, through resolutions published on 10 January 2000, ENARGAS approved the tariff effective as from 1 January 2000 without the PPI adjustment. The ENARGAS resolutions provided that the legal regime governing the tariffs would remain intact.
59. During the first six months of 2000, the situation in the Argentine economy continued to deteriorate. The semi-annual PPI adjustment would have forced a second tariff increase in a continued deflationary period. Although the licensees had agreed to only one-time tariff adjustment postponement, the Government urged the gas-distribution licensees to accept a second postponement of the tariff adjustments; including the previously postponed adjustments that were scheduled to be recovered beginning on 1 July 2000 in accordance with the *Acta Acuerdo* of 6 January 2000.
60. On 17 July 2000, by Decree No. 669/00, effective 4 August 2000, the licensees and the Government agreed to a second postponement of the tariff adjustments until 30 June 2002. Pursuant to the agreement, a stabilization fund would be created to recover the postponed amounts, subject to certain ceilings and floors, with interest. As with the previous agreement, this agreement reaffirmed the Government's commitments and guarantees provided to the licensees and their investors under the legal structure created for the privatization of the gas industry, specifically recognizing the enforcement of Argentina's bilateral investment treaties and the semi-annual PPI adjustments as an integral component of the tariff system.
61. On 3 August 2000, the Argentine National Ombudsman filed a lawsuit in an Argentine Federal Court, seeking an injunction against the operation of Decree No. 669/00. On 18 August 2000, the Court issued an order provisionally enjoining the application of Decree No. 669/00 and of the

agreement of 17 July 2000. On 5 October 2001, the Court of Appeal ratified the order and the case is presently pending before the Supreme Court (Respondent's Counter-Memorial, ¶ 255).

62. ENARGAS declared in November 2001 that no further adjustments to the tariffs would be approved until final judgment in the lawsuit. No further adjustments to the tariffs have occurred to date.

### **C. THE EMERGENCY LAW – 6 JANUARY 2002**

63. Argentina's crisis deepened at the end of 2001. The Government experienced increased difficulties in repaying its foreign debt. As poverty and unemployment soared, Argentines feared that the Government would default on its debt and immobilize bank deposits. Therefore, savings were massively withdrawn from the banks. In response, the Government issued Decree No. 1570/01, known as "*Corralito*," on 1 December 2001, restricting bank withdrawals and prohibiting any transfer of currency abroad. Amid widespread discontent and public demonstrations, including violence that claimed tens of lives, President De la Rúa and his Cabinet resigned on 20 December 2001. A succession of presidents took office and quickly resigned.
64. Finally, President Eduardo Duhalde took office and implemented a new economic plan, which contained measures that form the additional claim submitted by Claimants. On 6 January 2002, Congress enacted Law No. 25,561, the Public Emergency and Foreign Exchange System Reform Law (known as "the Emergency Law"). The Emergency Law abrogated the Convertibility Law so that the one-to-one peg of the Argentine peso to the United States dollar no longer existed. The Emergency Law provided for the switch into Argentine pesos of debts owed to the banking system, debts arising from management contracts governed by public law, and debts under private agreements. The law further provided for the renegotiation of private and public agreements to adapt them to the new exchange system.

65. The Emergency Law adopted measures modifying public-service contracts, such as establishing that tariffs and prices for public services were to be calculated in pesos, instead of U.S. dollars; abolishing all clauses calling for tariff adjustments in U.S. dollars or other foreign currencies; eliminating all indexing mechanisms; and directing the Executive Branch to renegotiate all public-service contracts.
66. By Presidential Decree No. 214 of 3 February 2002, the Government adopted a currency conversion scheme under which all obligations payable in dollars existing on the date of enactment of the Emergency Law would be converted into pesos at the fixed one-to-one exchange rate.
67. The switch into Argentine pesos, also called “pesification,” which affected the entire Argentine economy, was characterized by Respondent as a necessary process to return the country to the path of economic stability.

#### **D. RENEGOTIATION OF THE PUBLIC SERVICE CONTRACTS**

68. On 12 February 2002, Argentina announced the renegotiation of all public service contracts. By Decree No. 293/02, licenses for transport and distribution of natural gas were subject to mandatory renegotiation by a Renegotiation Committee within the Ministry of Economy. Under the Decree, the Government could either sign a renegotiated agreement or rescind the contract. By Resolution No. 38/02, issued on 9 March 2002, ENARGAS was ordered to discontinue all tariff reviews and to refrain from adjusting tariffs or prices in any way.
69. After enactment of the Emergency Law, the licensees and the Argentine Executive launched three initiatives to implement an emergency increase in the natural gas and electricity tariffs. Each of these initiatives was successfully challenged by consumer organizations and ombudspersons in the Argentine judiciary and consequently did not become effective. The Argentine Government attempted twice more in 2003 to obtain tariff

increases through Presidential Decrees but both these efforts were also quashed by the judiciary.

70. On 25 May 2003, a new Argentine President, Dr. Néstor Kirchner, took office after a popular election was held on 26 April 2003, replacing the transition authorities that had been appointed by the Argentine Congress. Respondent states that with the new administration, a period of institutional stabilization at the federal level began (Respondent's Counter-Memorial, 317).
71. By Presidential Decree No. 311/03, published on 4 July 2003, and Law No. 25,790, passed on 22 October 2003, the Argentine Government extended the renegotiation process. Centro, Cuyana and GasBan have been involved in the renegotiation process under threat of rescission of contract. During the renegotiation process, the Government has not offered to restore the legal guarantees that were eliminated by the Emergency Law, or compensate Claimants for any losses incurred.

#### **E. REQUEST FOR RELIEF**

72. Bearing in mind the background already described, Claimants request the following relief (Request for Arbitration, ¶ 111 as revised in Claimants' Memorial at ¶ 208):
  - (i) Declaring that the Respondent has breached its obligations under Article II(2)(c) of the Bilateral Treaty by failing to observe obligations that it entered into with regard to the Claimants' investment;
  - (ii) Declaring that the Respondent has breached its obligations under Article II(2)(a) of the Bilateral Treaty by failing to accord to the Claimants' investment fair and equitable treatment and by according treatment less than that required by international law;
  - (iii) Declaring that the Respondent has breached its obligations under Article II(2)(b) of the Bilateral Treaty by taking



arbitrary and discriminatory measures that impair the use and enjoyment of the Claimants' investment;

- (iv) Declaring that the Respondent has breached Article IV(1) of the Bilateral Treaty by indirectly expropriating the Claimants' investment without complying with the requirements of the Bilateral Treaty, including observance of due process of law and payment of prompt, adequate, and effective compensation;
- (v) Ordering the Respondent to pay the Claimants full compensation in the amounts set forth in the Memorial, plus pre- and post-award compound interest;
- (vi) Ordering the Respondent to pay all costs and expenses of this arbitration proceeding, including the fees and expenses of the Tribunal and the cost of the Claimants' legal representation, plus interest thereon in accordance with the Bilateral Treaty; and
- (vii) Such other or additional relief as may be appropriate under the Bilateral Treaty or may otherwise be just and proper.

73. According to Claimants' Reply (¶ 287), the relief they seek is stated as follows:

- 1. Finding the Argentine Republic to be in breach of its obligations under the Treaty;
- 2. Ordering the Argentine Republic to pay LG&E: (i) compensation in the amounts specified in Part VI of [the] Reply; (ii) all costs and fees of the arbitration, including reasonable attorneys' fees; and (iii) compound interest on the monetary award from the date of the award until the date of actual payment; and
- 3. Ordering such additional relief as may be appropriate under the applicable law or otherwise just and proper.

74. The monetary relief sought by Claimants is US\$ 248 million or, if the Tribunal concludes that there was expropriation, US\$ 268 million, plus compound pre-award and post-award interest and costs.

75. Respondent denies that it has violated the Treaty and seeks an order from

this Tribunal dismissing LG&E's claims and holding LG&E liable for costs. In asserting its defense, Respondent contends in the alternative that the circumstances warrant application of the state of necessity defense, thus exempting it from liability for any Treaty violations.

## V. PRELIMINARY MATTERS

76. In the analysis below, the Tribunal has not only considered the positions of the parties as summarized in the various sections above, but also their numerous detailed arguments in support of those positions as well as the arguments made at the hearing. To the extent that these arguments are not referred to expressly, they must be deemed to be subsumed in the analysis below.

### A. JUS STANDI

77. With respect to *jus standi*, the Tribunal re-affirms its conclusions adopted in the Decision on Objections to Jurisdiction of 30 April 2004. As determined in the Decision on Jurisdiction, the Centre has jurisdiction over LG&E's claims and this Tribunal is competent to decide on Claimants' claims.

78. Argentina continues to argue that this Tribunal shall only have jurisdiction if Argentina's non-compliance with an international obligation is verified (Respondent's Rejoinder, ¶ 521(a)). Pursuant to the Tribunal's Decision on Jurisdiction issued on 30 April, 2004, the Tribunal deems that all the obligations in discussion are international because they relate to the Treaty. Thus, LG&E's minority-shareholder status has no bearing on its standing to bring these claims or on the Tribunal's competence to rule upon them.

79. It should be pointed out that, as this Tribunal stated in the Decision on Jurisdiction, the subject matter of this arbitration focuses on the investments made by LG&E in the Argentine licensees. Accordingly, the Tribunal has insisted on the independent treatment of LG&E regarding the licensees, both from the point of view of the legal personality of each entity and from the

actions of each. This does not mean, however, that certain actions of the licensees, by the fact that they are the investment's beneficiaries, may have, in some cases, effects on the investment itself. For such reasons, on occasion, the Tribunal shall be bound to refer to the licensees and their actions without implying a reference to LG&E. One should bear in mind that the recognition of the independence among these entities was the basis on which the jurisdiction of the Centre and the competence of the Tribunal were supported.

## **B. LAW APPLICABLE**

### **1. Parties' Positions**

80. The Claimants argue that their claims asserted arise under the Treaty. The law that applies to the dispute is therefore the Treaty and general international law. Claimants contend that this approach comports with the first part of Article 42(1) of the ICSID Convention. In Claimants' view, Argentine law merely establishes a factual predicate for the claims under the Treaty and general international law (Claimants' Memorial, ¶¶ 155-56).
81. Respondent does not deny the application of the Bilateral Treaty to this dispute, but argues that in the absence of an agreement on the applicable law, the relationship between LG&E and the Argentine Government should be subject to the second part of Article 42(1) of the ICSD Convention, which establishes the precedence of sources of law; therefore, the Argentine law should be applied first. Respondent asserts that "where an investor makes an investment in a State it is subject –as are local investors– to the laws of the country where the investment is made" (Respondent's Counter-Memorial, ¶ 25). Argentina stresses the insufficiency of the Treaty to govern the dispute at issue, particularly in light of the substantive framework regarding the foreign investment's treatment under Argentine law.

## 2. Tribunal's Analysis

82. In accordance with Article 42(1) of the ICSID Convention:

“(1) The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of International Law as may be applicable.”

83. This rule grants the parties' autonomy in choosing the law applicable to the substance of the dispute in an arbitration administered by ICSID. If no applicable law is chosen, the Tribunal must resort to the second sentence of Article 42(1).

84. It is evident that the parties hereto had not agreed on the applicable law in this dispute. This is usually found in the investment agreement, though this does not hold in this case. Nor is there any express reference to the applicable law in other documents related to the investment by LG&E, a fact that would result in the application of the second part of Article 42(1).

85. It is to be noted that the Argentine Republic is a signatory party to the Bilateral Investment Treaty, which may be regarded as a tacit submission to its provisions in the event of a dispute related to foreign investments. In turn, LG&E grounds its claim on the provisions of the Treaty, thus presumably choosing the Treaty and the general international law as the applicable law for this dispute. Nevertheless, these elements do not suffice to say that there is an implicit agreement by the Parties as to the applicable law, a decision requiring more decisive actions. Consequently, the dispute shall be settled in accordance with the second part of Article 42(1).<sup>3</sup>

86. In addition to the indication of the applicable law, there are two other

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<sup>3</sup> Schreuer, Christoph, *The ICSID Convention: A Commentary*, Cambridge University Press, 2001, p. 573.

concepts embedded in the second part of Article 42(1) which deserve comment—the references to private international law and to the rules of international law “as may be applicable”.

87. As to the reference to the private international law, the Tribunal has not found in the ICSID records any case in which the Arbitral Tribunal has resorted to the rules of conflict of law of the State party to the dispute. It has been so observed in the *Amco v. Indonesia* case, in which the Arbitral Tribunal, presided by Berthold Goldman, affirmed that it did not deem it necessary to enter into a discussion on the rules of conflict, inasmuch as the parties make constant references to the law of the State party in the dispute and, moreover in “the dispute before the Tribunal relating to an investment in Indonesia, there is no doubt that the substantive municipal rules of law to be applied by the Tribunal are to drawn from Indonesian Law.”<sup>4</sup> The Tribunal in this case shares the same criterion.
88. With reference to the rules of international law and, particularly, to the language “as may be applicable,” found in Article 42(1) of the ICSID Convention, the Tribunal holds the view that it should not be understood as if it were in some way conditioning application of international law. Rather, it should be understood as making reference, within international law, to the competent rules to govern the dispute at issue.<sup>5</sup> This interpretation could find support in the ICSID Convention’s French version that refers to the rules of international law “*en la matière*.”<sup>6</sup>

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<sup>4</sup> *Amco Asia Corporation and others v. Republic of Indonesia*, Award of 20 November 1984, 1 ICSID Rep. 413 (1993).

<sup>5</sup> “It simply means that the relevant rules of international law are to be applied.” Schreuer, Cristoph, *The ICSID Convention...op.cit.*, p. 622.

<sup>6</sup> *Convention CIRDI, Art. 42*: “(1) (1) Le Tribunal statue sur le différend conformément aux règles de droit adoptées par les parties. Faute d'accord entre les parties, le Tribunal applique le droit de l'Etat contractant partie au différend—y compris les règles relatives aux conflits de lois—ainsi que les principes de droit international **en la matière**” (emphasis added). In: <http://www.worldbank.org/icsid/basicdoc-fra/partA-chap04.htm#s03>.

89. Likewise, applying the rules of international law is to be understood as comprising the general international law, including customary international law, to be used as an instrument for the interpretation of the Treaty. For example, where a term is ambiguous, or where further interpretation of a Treaty provision is required, the Tribunal will turn to its obligations under Articles 31 and 32 of the Vienna Convention on the Law of Treaties, signed in 1969.
90. Having made this part clear, the Tribunal proceeds to analyze the extension of the remission to the domestic law contained in the second part of Article 42(1), whereby the Tribunal shall apply “the law of the Contracting State Party to the dispute...” The Argentine doctrine contributes to gaining insight into the remission’s scope: “the situation is much clearer by virtue of the incorporation of the international law to the Argentine law and the hierarchical relation conferred by the 1994 constitutional reform to international treaties in Article 75, paragraph 22,<sup>7</sup> of the National Constitution.”<sup>8</sup>
91. The Tribunal notes that as part of the Argentine legal system, the Bilateral Treaty prevails over domestic law, “especially, inasmuch as in most of the Bilateral Treaty’s assumptions there is an express mention of international law, be it when referring to the treatment to be given to investments, or to the compensation in the event of expropriation or any other like measure, etc.”<sup>9</sup>
92. This interpretation has been accepted in Argentina “as long as the litigation is linked to the violation of the BIT [bilateral investment treaty] and of international law and not to the mere pretensions of infringement of a local

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<sup>7</sup> “... the treaties and concordats are hierarchically superior than laws ...”

<sup>8</sup> Tawil, Guido Santiago, *Los conflictos en materia de inversión, la jurisdicción del CIADI y el Derecho aplicable: a propósito de las recientes decisiones en los casos “Vivendi”, “Wena” y “Maffezini”*, in *RAP*, October 2002 Year XXV, N° 239, pp. 241 *et seq.*, especially pp. 256-257.

contract and as the parties should have not provided expressly the law applicable to the first of said disputes, the decision shall be governed by the ICSID Convention, by the BIT and applicable international law. Thus, the BIT becomes the *lex specialis* regarding disputes appearing in matters of investment between the foreign investor and the Host State.”<sup>10</sup>

93. It is this Tribunal’s opinion that obviating application of international law, specifically of the ICSID Convention and the Bilateral Treaty, would entail ignoring the fact that “international treaties move away from the principle according to which foreign investment is subject to the law and jurisdiction of the host state and seek international solution of conflicts.”<sup>11</sup> This thesis, held by part of the Argentine doctrine, indicates that when submitting the settlement of a dispute to an Arbitral Tribunal acting within the framework of an international agreement, like ICSID, the dispute falls under public international law; thus its rules are to be applied.<sup>12</sup> However, the problem is more complex as has been admitted by several scholars, who are of the opinion that it is necessary to “balance the weight that domestic law and international law should have upon the settlement of the dispute”<sup>13</sup>, this is, to establish an order of precedence of the sources.
94. International law overrides domestic law when there is a contradiction since a State cannot justify non-compliance of its international obligations by asserting the provisions of its domestic law.
95. If this contradiction does not exist, it is not an easy task to establish the relationship between international law and domestic law. In the original draft of the ICSID Convention, the conjunction “and” was not present in the rule,

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<sup>9</sup> *Idem*, p. 256. The author bases his opinion on the *Vivendi* case.

<sup>10</sup> *Ibidem*.

<sup>11</sup> See *Investment for foreigners in Argentina*: [www.enplenitud.com/](http://www.enplenitud.com/)

<sup>12</sup> Grigera Naón, Horacio, *Choice of Law Problems in International Commercial Arbitration*, J.C.B. Mohr (Paul Siebeck) Tübingen, Germany, 1992, p. 115.

<sup>13</sup> Vives Chillida, Julio, *El Centro Internacional de Arreglos de Diferencias Relativas a Inversiones*

but rather the conjunction “or” was in its place, so that it read, “The Arbitral Tribunal shall decide the dispute submitted to it in accordance with such rules of law, whether national or international as it shall determine to be applicable.”<sup>14</sup> The intention in the language of the original draft was not to establish an order of preference, but rather to establish the possibility of alternatives. Initially, scholarly authorities and some ICSID Tribunals admitted that the conjunction “and” meant that “and in case of lacunae, or should the law of the Contracting State be inconsistent with international law.”<sup>15</sup> However, any limitation to the role of international law under these terms would imply accepting that international law may be subordinate to domestic law and would obviate the fact that there are a growing number of arbitrations initiated on the basis of bilateral or multilateral investment treaties.

96. It is this Tribunal’s opinion that “and” means “and,” so that the rules of international law, especially those included in the ICSID Convention and in the Bilateral Treaty as well as those of domestic law are to be applied. In the *Wena Hotels Limited v. Arab Republic of Egypt* case, the Tribunal affirmed that “and means and”, but accepted the supremacy of international law.<sup>16</sup>
97. The Tribunal concludes, as the tribunal concluded in the *Asian Agricultural Products, Ltd, (AAPL) v. Democratic Socialist Republic of Sri Lanka*, Award of June 27, 1990, that the Treaty “is not a self-contained closed legal system limited to provide for substantive material rules of direct applicability, but it has to be envisaged within a wider juridical context in which rules from other sources are integrated through implied incorporation methods, or by

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(*CIADI*), Madrid, McGraw Hill, 1998, p. 195.

<sup>14</sup> Schreuer, Christoph, *The ICSID Convention... op. cit.*, p. 623.

<sup>15</sup> Gaillard, Emmanuel and Banifetami, Yas, *The Meaning of “and” in Article 42(1), second sentence, of the Washington Convention: The Role of International Law in the ICSID choice of the law process*, ICSID Review, Foreign Investment Law Journal, 2003, Vol. 12, No. 2, pp. 375 et seq., especially pp. 381-382. See also: Schreuer, Christoph, *op. cit.*, p. 263.

<sup>16</sup> *Wena Hotels Limited v. Arab Republic of Egypt*, ICSID Case N° ARB/98/4, Decision on Application

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direct reference to certain supplementary rules, whether of international law character or of domestic law nature.”<sup>17</sup>

98. In short, one must also recall that between Argentina and LG&E there is no binding contractual agreement. The existence of such relationship would have allowed the parties to agree on stabilization clauses in the event of changes in certain circumstances. But, in the absence of such agreement, one is bound to resort to a legal system regulating those events. The fact that there is no contract between the Argentine Republic and LG&E favors in the first place, the application of international law, inasmuch as we are dealing with a genuine dispute in matters of investment which is especially subject to the provisions of the Bilateral Treaty complemented by the domestic law.

### **3. Tribunal’s Conclusion**

99. In order to settle this controversy, the present Tribunal shall apply first the Bilateral Treaty; second and in the absence of explicit provisions therein, general international law, and, third, the Argentine domestic law, particularly the Gas Law that governs the natural gas sector. The latter is applicable in view of its relevance for determining the Argentine Republic’s liability and the defenses to which it may resort vis-à-vis the allegations made by Claimants.

## **VI. LIABILITY**

### **A. ARTICLE II(2)(a): FAIR AND EQUITABLE TREATMENT**

#### **1. Parties’ Positions**

100. Based on the circumstances of this case as described in Section IV above,

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for Annulment, Feb. 5, 2002, 41 ILM 933 (2002).

<sup>17</sup> *Asian Agricultural Products Ltd. (AAPL) v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/87/3, Final Award, June 27, 1990, 6 ICSID Review 533 (1991).

LG&E claims that the Argentine Republic breached Article II(2)(a) of the Bilateral Treaty, which guarantees that LG&E's investment in Argentina will at all times be accorded fair and equitable treatment.

101. In Claimants' view, by committing itself to the Treaty, Argentina made promises to the United States as to how it would treat the investments of U.S. nationals in Argentina. In Article II, Argentina agreed to maintain an investment environment that is even-handed towards all investors, foreign and domestic alike, free of arbitrary and discriminatory laws and regulations, and ultimately fair and equitable, offering full protection and security to the investments of U.S. nationals.

102. Claimants explain that fair and equitable treatment in the context of this Treaty, requires a stable and predictable legal framework for the investment. Claimants support their interpretation of the standard on the basis of the Preamble of the Treaty, which sets forth the object and purpose of the Treaty and specifically the provision on fair and equitable treatment, as well as three recent opinions of arbitral tribunals considering the question in a similar context.<sup>18</sup> Claimants contend that, under this standard, a State cannot grant treatment that affects the basic expectations that were taken into account by the foreign investor to make the investment. Considering that the Treaty's objective was to promote foreign investment, Claimants argue that the stability and predictability of the legal framework that laid the foundations for their investment and granted protection to its value are particularly important.

103. With respect to Respondent's reliance on the *Genin* case, Claimants argue

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<sup>18</sup> *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States*, ICSID Case No. ARB (AF)/00/02 Award ¶ 154 (29 May 2003); *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7 Award ¶ 113 (25 May 2004); *Occidental Exploration and Production Company v. The Republic of Ecuador*, LCIA Case No. UN 3467 Final Award (1 July 2004).

that as the *Genin*<sup>19</sup> case is merely a standard for evaluating the fairness and equity of State procedures, such a standard should be evaluated in light of more recent cases.

104. Claimants also contend that the extent to which the fair and equitable standard relates to the minimum standard of treatment under customary international law makes no difference in this case because that standard has evolved since the *Mondev*<sup>20</sup> case to include the reasonable expectations of the investor.
105. Under this articulation of the standard, Claimants state that Argentina treated LG&E's investment in an unfair and inequitable manner. *First*, Argentina repudiated the guarantees that it had offered to the foreign investors at the time it induced them to invest in Argentina. *Second*, Argentina singled out the gas-distribution industry and other public utility industries, for treatment that was less favorable than the treatment granted to all other sectors of the economy. *Third*, Argentina publicized unfounded charges against the foreign investors and coerced the gas-distribution companies to waive their rights under the licenses and renegotiate the licenses. *Fourth*, Argentina held the licensees responsible for strict compliance with the terms of the licenses while the Government froze the gas-distribution tariffs. *Finally*, Claimants allege that Argentina foreclosed the licensees from pursuing judicial or arbitral remedies (Claimants' Memorial, ¶ 171).
106. Argentina had attracted Claimants with the guarantees derived from the Treaty and the legal framework for privatization, under which its laws and regulations guaranteed how Argentina would treat LG&E's investment. In making their decision to invest in Argentina, Claimants relied on Argentine

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<sup>19</sup> *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*, ICSID Case No. ARB/99/2 Award, ¶ 367 (25 June 2001).

<sup>20</sup> *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)99/2, Award, ¶ 116 (October 11, 2002).

laws that granted protection against currency fluctuation and inflation, while providing for adjustment of utility rates, thus ensuring reasonable rates of return and that the Argentine Government would not freeze utility rates, but rather maintain a dynamic tariff system, regulated by an expert agency.

107. Claimants did not expect their investment to be free of risk, or that Article II of the Bilateral Treaty should protect them from all risks associated with their investment. But they insist that the gas regulatory framework that Argentina put in place made their investment free from risk of regulatory alterations or changes in the rules in which they had invested. LG&E understood that it would bear what it calls “commercial risks,” such as industry demand, recession and substitution of natural gas by alternative fuels (Hearing on the Merits, Perkins, 24 January, 2005, Spanish Transcript, p. 369; Claimants’ Post-Hearing Brief, ¶ 8).
108. Claimants allege that, during the economic crisis, Argentina abandoned the guarantees that it made to investors in the gas-distribution sector. In January 2002, the Emergency Law swept away the protection against inflation. Argentina forced licensees to enter into two agreements postponing the PPI adjustments, after which an Argentine court issued an order that ENARGAS interpreted as an injunction against the PPI adjustment. The Emergency Law permanently abolished the PPI adjustment.
109. The Emergency Law also abandoned the protection against currency fluctuations. The Gas Law had guaranteed that the tariffs would be calculated in dollars and converted into pesos. In reliance on this protection against any sharp devaluation of the peso, Claimants decided to invest in the licensees.
110. In light of these prior measures, Claimants argue that Argentina repudiated its guarantee that generally prohibited the freezing or control of tariffs (Claimants’ Post-Hearing Brief, ¶¶ 15-31).
111. While Claimants acknowledge that the material used by Respondent in order

to make the offer was not binding, the laws and promises referenced therein were (Claimants' Post-Hearing Brief, ¶ 9). Claimants add that if establishing the tariffs had been left to the State, investors would have never invested.

112. Respondent objects to the definition given to fair and equitable treatment. In Respondent's view, the standard should be defined by impartial and objective rather than personal and arbitrary criteria. They conclude that Claimants' interpretation of the standard is so vague as to ignore the parties' obligations and rights (Respondent's Counter-Memorial, ¶ 603-604).
113. Citing *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*<sup>21</sup> and *Robert Azinian, Kenning Davitian & Ellen Baca v. The United Mexican States*<sup>22</sup>, Respondent concludes that the fair and equitable treatment principle refers to the international minimum standard of treatment owed to an investor, and as such, constitutes a minimum pattern for substantive justice (Respondent's Counter-Memorial, ¶ 620). Respondent also contends, citing *S.D. Myers Inc. v. The Government of Canada*<sup>23</sup> that a violation of the fair and equitable standard "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" (Respondent's Counter-Memorial, ¶¶ 621-622).
114. Regarding the list of guarantees cited by Claimants, Respondent contends that the Gas Law does not provide for what Claimants call "exchange protection" (Respondent's Post-Hearing Brief, ¶ 74a). Respondent points out that, in fact, when Claimants' witnesses were examined, they were not able to identify where any such "protection" had been established. Respondent also asserts that the tariff calculation in U.S. dollars was linked to the

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<sup>21</sup> See *Genin*, footnote No. 19 *supra*.

<sup>22</sup> *Robert Azinian and others v. United Mexican States*, ICSID Case No. ARB(AF)/97/2, Award, ¶¶ 83 and 87, (1 November 1999).

<sup>23</sup> *S.D. Myers, Inc. v. Government of Canada*, NAFTA Arbitration under UNCITRAL Rules, Partial

footnote cont'd

existing fixed rate of exchange between the peso and the U.S. dollar as established by the Convertibility Law. None of Claimants' witnesses was able to prove the opposite. Respondent adds that maintaining tariffs linked to the U.S. dollar after the convertibility system was abandoned lacks any economic logic. Respondent points out that none of the Government's guarantees address the abandonment of convertibility.

115. With respect to the tariff guarantee, Respondent argues that it is possible that the Argentine authorities had considered guaranteeing the calculation of the tariffs in U.S. dollars regardless of the Convertibility Law, but such plan was rejected due to the fact that the Government concluded that the Convertibility Law provided sufficient protection to the investment (Respondent's Post-Hearing Brief, ¶ 26).
116. With respect to the PPI adjustments, Respondent argues that from mid-1998, application of the PPI as the rate adjustment index became unreasonable and failed to fulfill the goal it was conceived for – namely, reflecting the changes in the value of the goods and services involved in the activity of service providers (Respondent's Post-Hearing Brief, ¶ 44). Additionally, Respondent states that the measure did not cause loss to the licensees. Citing the opinions of Schwartz and Lapuerta, Respondent contends that suspension of the PPI adjustment would have affected tariffs only by approximately 2% between August 2000 and October 2002 (Respondent's Post-Hearing Brief, ¶ 46).
117. Respondent agrees that the tariffs must be fair and sufficient, yet not abusive, something that would occur if the Claimants' position were sustained (Respondent's Post-Hearing Brief, ¶ 74c).
118. Regarding the claim that the Claimants were "induced" to invest in the Argentine Republic, Respondent argues that there is no proof of such

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Award, ¶ 263, (13 November 2000).

inducement (Respondent’s Counter-Memorial, ¶ 647). Respondent points out that the Claimants rely on non-binding documents, such as reports and minutes without any legal relevance. According to Respondent, these documents were irrelevant to the laws that should have been considered in deciding whether or not to invest in the Argentine gas-distribution market (Respondent’s Post-Hearing Brief, ¶ 17).

**2. Tribunal’s Conclusion Concerning Argentina’s Guarantees to Investors**

119. The Tribunal concludes that the Gas Law and its implementing regulations made four guarantees to investors in the gas transport and distribution centers:

1. Article 41.1 of Decree No. 1738/92,<sup>24</sup> and Section 9.2 of the Basic Rules of the License<sup>25</sup> mandated that the tariffs would be calculated in U.S. dollars before conversion into pesos.
2. Section 9.4.1.1 of the Basic Rules of the License guaranteed that the tariffs would be subject to semi-annual adjustments according to the PPI.<sup>26</sup>
3. Article 38 of Law No. 24,076 provided that tariffs were to provide an income sufficient to cover all costs and a reasonable rate of return.<sup>27</sup>

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<sup>24</sup> Article 41.1 provides: “Transportation and Distribution rates shall be calculated in United States dollars. The resulting Rate Schedule shall be stated in Argentine pesos and shall be convertible as stated in Law No. 23,928, using for the retranslation into Argentine pesos the parity set forth in Article 3 of Argentine Presidential Decree No. 2,128/91.”

<sup>25</sup> Section 9.2 provides: “The tariff has been calculated in U.S. dollars. The adjustments referred to in point 9.3 will be calculated in U.S. dollars.”

<sup>26</sup> Section 9.4.1.1 provides: “Distribution tariffs will be adjusted semiannually according to the variation operated in the PPI.”

<sup>27</sup> Article 38 provides: “The services rendered by distributors will be offered at tariffs in line with the following principles:

a) To provide distributors who operate economically and prudently the opportunity to obtain sufficient income to meet all reasonable operating costs applicable to the service, taxes, amortization, and a

footnote cont’d

4. Section 9.8 of the Basic Rules of the License guaranteed that the tariff system would not be subject to freezing or price controls without compensation.<sup>28</sup>
120. The Tribunal also finds that as a matter of fact, the Emergency Law, passed on 6 January 2002, declared that the tariffs would no longer be calculated in U.S. dollars but directly in pesos (Article 8), and that there would be no further semi-annual tariff adjustments according to the PPI (Article 8). The Tribunal notes that since July 1999, there have not been any PPI adjustments in the tariffs relating to the licensees and the five-year review due in 2002 was not conducted – both affecting the level of the tariffs in the gas-distribution sector and, as a consequence, Claimants’ rate of return on their investment. Argentina took these steps without compensating Claimants and forcing Claimants to renegotiate (a process in which an Argentine official recommended that investors waive their claims against the Government relating to the licenses) or face rescission of the licenses. (Decree No. 293/02, Article 2 and Claimants’ Memorial ¶¶ 120 *et seq*).

### **3. Tribunal’s Analysis**

121. The question before the Tribunal is whether the measures implemented by Argentina violated Argentina’s obligation under Article II(2)(a) of the Treaty to give fair and equitable treatment to LG&E’s investment.
122. The Treaty does not define what is meant by fair and equitable treatment. In these circumstances, the Tribunal must interpret this provision in good faith, in accordance with the ordinary meaning to be given to the terms in their context, and in light of its object and purpose, as required by Article 31(1) of

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reasonable rate of return, as determined in the following article.”

<sup>28</sup> Section 9.8 provides: “Licensee’s tariff system will not be subject to freezing, administration and/or price control. If, in spite of this stipulation, Licensee is forced to adapt to a price control system establishing a lower level than that arising from the Tariff, Licensee will have the right to be compensated by the Government in an equivalent amount.”



the Vienna Convention.

123. The Treaty, following the general trend with investment treaties, provides for treatment applicable to investors in the host State through the establishment of a series of internationally recognized standards.<sup>29</sup> Due to the fact that such international standards have a generic nature and that their interpretation varies with the course of time and with the circumstances of each case, it becomes difficult to establish an unequivocal and static concept of these notions.
124. In considering the context within which Argentina and the United States included the fair and equitable treatment standard, and its object and purpose, the Tribunal observes in the Preamble of the Treaty that the two countries agreed that “fair and equitable treatment of investment is desirable in order to maintain a stable framework for investment and maximum effective use of economic resources.” In entering the Bilateral Treaty as a whole, the parties desired to “promote greater economic cooperation” and “stimulate the flow of private capital and the economic development of the parties”. In light of these stated objectives, this Tribunal must conclude that stability of the legal and business framework is an essential element of fair and equitable treatment in this case, provided that they do not pose any danger for the existence of the host State itself.
125. Several tribunals in recent years have interpreted the fair and equitable treatment standard in various investment treaties in light of the same or

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<sup>29</sup> The notion of a standard appeared for the first time in a 1948 treaty, the Havana Charter for an International Trade Organization, and it was considered a protection against state actions violating internationally-accepted rules. In the 1960s it was related to the protection given to foreign properties. In international case law, the standard existed pursuant to the interpretation provided in the 1920s in the emblematic *Neer* case, which required that State conduct be deemed outrageous, wrongful, open injustice, an atrocity, bad faith or voluntary negligence of duty for a violation to be found. That interpretation is not the same that is given today. What was considered an “atrocity” in 1926 might not be so today, and what may be considered “violent” now, may not have been at that time. See “*Fair and Equitable Treatment Standard in International Investment Law*”, OECD, Working Paper on

footnote cont’d

similar language as the Preamble of the Argentina – U.S. BIT.<sup>30</sup> These tribunals have repeatedly concluded based on the specific language concerning fair and equitable treatment, and in the context of the stated objectives of the various treaties, that the stability of the legal and business framework in the State party is an essential element in the standard of what is fair and equitable treatment.<sup>31</sup> As such, the Tribunal considers this interpretation to be an emerging standard of fair and equitable treatment in international law.

126. Although the Chile - Malaysia BIT does not include express reference in its Preamble with respect to fair and equitable treatment, the tribunal in *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile* referred to the objectives of the Treaty set forth in the Preamble, and concluded that in light of these objectives, fair and equitable treatment meant treatment in an “even-handed and just manner, conducive to fostering the promotion of foreign investment.”<sup>32</sup>
127. In addition to the State’s obligation to provide a stable legal and business environment, the fair and equitable treatment analysis involves consideration of the investor’s expectations when making its investment in reliance on the protections to be granted by the host State. Indeed, this view is reflected in the *Tecmed* decision, that has been adopted by a succession of tribunals:

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International Investment, November 2003/4.

<sup>30</sup> See, e.g., *CMS Gas Transmission Company v. The Argentine Republic*, ICSID Case No. ARB/01/8 Award (12 May 2005) (Argentina-U.S. BIT); *Occidental Exploration and Production Company v. The Republic of Ecuador*, LCIA Case No. UN 3467 Final Award (1 July 2004) (U.S.-Ecuador BIT – almost identical language); *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7 Award ¶ 113 (25 May 2004) (Malaysia-Chile BIT); *Metalclad Corporation v. United Mexican States*, ICSID Case No. ARB(AF)/97/1 Award ¶ 75 (30 August 2000). (An underlying objective of Article 102(1) of NAFTA is “to promote and increase cross-border investment opportunities and ensure the successful implementation of investment initiatives”).

<sup>31</sup> *CMS*, ¶ 274; *Occidental*, ¶183. See also *Metalclad*, ¶ 99 (“Mexico failed to ensure a transparent and predictable framework for Metalclad’s business planning and investment”).

<sup>32</sup> *MTD*, ¶ 113.

“The Arbitral Tribunal considers that this provision of the [BIT], in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations.<sup>33</sup>”

128. Similarly, the tribunal in *Waste Management, Inc. v. The United Mexican States*, interpreting the fair and equitable treatment standard under NAFTA Article 1105(1) concluded that in applying the fair and equitable treatment standard, “it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.”<sup>34</sup> This means that violations of the fair and equitable treatment standard may arise from a State’s failure to act with transparency –that is, all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made under an investment treaty should be capable of being readily known to all affected investors.<sup>35</sup>
129. The Tribunal is not convinced that bad faith or something comparable would ever be necessary to find a violation of fair and equitable treatment. The tribunal in *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*,<sup>36</sup> did not reach this conclusion either. The tribunal merely stated: “Acts that would violate this minimum standard would

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<sup>33</sup> *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/02, Award ¶ 154 (29 May 2003); cited in e.g., *MTD*, ¶ 114; *Occidental*, ¶ 185; *CMS*, ¶ 279.

<sup>34</sup> *Waste Management, Inc. v. The United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award ¶ 98 (30 April 2004).

<sup>35</sup> See e.g., *Tecmed*, ¶ 154; *CMS*, ¶¶ 278-79 and *Occidental*, ¶ 185 (citing the *Tecmed* and *Metalclad* passages referring to transparency).

*include* acts showing a willful neglect of duty . . . or even subjective bad faith” (emphasis added).<sup>37</sup> The tribunal concluded that bad faith was not a requirement for a finding of a violation of fair and equitable treatment.<sup>38</sup>

130. It can be said that the investor’s fair expectations have the following characteristics: they are based on the conditions offered by the host State at the time of the investment; they may not be established unilaterally by one of the parties; they must exist and be enforceable by law; in the event of infringement by the host State, a duty to compensate the investor for damages arises except for those caused in the event of state of necessity; however, the investor’s fair expectations cannot fail to consider parameters such as business risk or industry’s regular patterns.
131. Thus, this Tribunal, having considered, as previously stated, the sources of international law, understands that the fair and equitable standard consists of the host State’s consistent and transparent behavior, free of ambiguity that involves the obligation to grant and maintain a stable and predictable legal framework necessary to fulfill the justified expectations of the foreign investor.

#### **4. Tribunal’s Conclusion**

132. In light of the foregoing, the Tribunal concludes that Argentina violated the fair and equitable treatment provision in the Bilateral Treaty for the following reasons.
133. Emerging from the economic crisis of the late 1980s, Argentina created an

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<sup>36</sup> *Genin*, ¶ 367.

<sup>37</sup> *Ibidem*.

<sup>38</sup> See, e.g., *Mondev*, ¶ 116 October 11, 2002 (“To the modern eye, what is unfair or inequitable need not equate with the outrageous or the egregious. In particular, a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith.”); see also *Occidental*, ¶ 63 (“this is an objective requirement that does not depend on whether the Respondent has proceeded in good faith or not.”); see also *Tecmed*, ¶ 153 (relying on *Mondev*); *Waste Management*, ¶ 93 (rejecting the standard set forth in the *Neer* case involving willful neglect of duty and bad faith).

economic recovery plan mainly dependent upon foreign capital. Argentina prepared with the investment banks an attractive framework of laws and regulations that addressed the specific concerns of foreign investors with respect to the country risks involved in Argentina. In light of these risks, Claimants relied upon certain key guarantees in the Gas Law and implementing regulations, such as calculation of the tariffs in U.S. dollars before their conversion into pesos, the semi-annual PPI adjustments, tariffs set to provide sufficient revenues to cover all the costs and a reasonable rate of return, and compensation in the event that the Government altered the tariff scheme. Having created specific expectations among investors, Argentina was bound by its obligations concerning the investment guarantees vis-à-vis public utility licensees, and in particular, the gas-distribution licensees. The abrogation of these specific guarantees violates the stability and predictability underlying the standard of fair and equitable treatment.

134. Specifically, it was unfair and inequitable to pass a law discarding the guarantee in Decree No. 1738/92 that the tariffs would be calculated in U.S. dollars and then converted into pesos. As pointed out by Claimants, this was not merely an economic and monetary policy of the Argentine Government which materialized through the Convertibility Law. Rather, it was a guarantee laid down in the tariff system. This guarantee was very important to investors to protect their investment, which was made in dollars, from a subsequent devaluation of the peso.
135. Argentina also acted unfairly and inequitably in the manner in which it abrogated the guarantees of the Gas Law and its implementing regulations, adversely affecting the gas-distribution sector but not affecting other sectors of the economy. For example, certain contracts, such as those in the export industry, were excluded from the forced conversion to pesos regulation, or the conversion was performed at a more favorable rate to the individual or company.

136. Argentina acted unfairly and inequitably when it prematurely abandoned the PPI tariff adjustments and essentially froze tariffs prior to the onset of the public disorder and threats to its essential security in December 2001, and when it refused to resume adjustments when conditions had normalized in April 2003, forcing instead the licensees to renegotiate.<sup>39</sup> History has shown that the PPI adjustments that initially were supposed to be postponed have been abandoned completely and are now being “negotiated” away.
137. Argentina also has acted unfairly and inequitably in forcing the licensees to renegotiate public service contracts, and waive the right to pursue claims against the Government, or risk rescission of the contracts. Even though the Gas Law provided for the renegotiation of public service contracts, in practice there was no real renegotiation, but rather the imposition of a process.
138. Likewise, the Government’s Resolution No. 38/02 issued on 9 March 2002, which ordered ENARGAS to discontinue all tariff reviews and to refrain from adjusting tariffs or prices in any way, also breaches the fair and equitable treatment standard.
139. The Tribunal nevertheless recognizes the economic hardships that occurred during this period, and certain political and social realities that at the time may have influenced the Government’s response to the growing economic difficulties. Certainly, LG&E was aware of the risks inherent in investing in a foreign State. But here, the Tribunal is of the opinion that Argentina went too far by completely dismantling the very legal framework constructed to attract investors.

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<sup>39</sup> As described more fully below, Argentina is excused from liability for the measures taken during the extreme circumstances of December 2001 until April 2003 in order to maintain public order and protect its essential interests. It was fair that during this period of time, Argentina suspended the guarantees of the Gas Law and postponed the PPI tariff adjustments until such time as the Government could manage to resume its obligations.

## **B. ARTICLE II(2)(b): DISCRIMINATORY AND ARBITRARY TREATMENT**

### **1. Discriminatory Treatment**

#### **(i) Parties' Positions**

140. Claimants contend that the Argentine Government adopted measures that discriminated against the downstream gas sector (transport and distribution) compared to upstream businesses (production), large industrial customers, and other sectors not dominated by foreign investors, such as alternative energy and the public. In their view, such discrimination violates Article II(2)(b) of the Bilateral Treaty, which provides that “[n]either Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments.”
141. Claimants state that, from the time of the first PPI adjustment until the enactment of the Emergency Law of 6 January 2002, the gas industry received treatment different from that accorded to similarly situated public utilities, including electricity and water distribution companies. These other public utilities continued to enjoy the PPI adjustment until the enactment of the Emergency Law.
142. Claimants also support their contention by pointing out that, following enactment of the Emergency Law on 6 January 2002, the Government subjected most of the privatized public-utility sector, including the gas-distribution industry, to the least favorable of several regimes devised for the conversion of dollar obligation into pesos. Within the public-utility sector, Claimants also allege that the Government discriminated against the gas-distribution industry by excluding other public-service companies from the conversion of tariffs into pesos. The Government imposed upon the privatized gas-distribution companies what was considered the worst exchange and tariff system during the Argentine crisis.

143. Claimants stress that if one compares the measures that affected sectors such as gas production, alternative energy sources or even those of the public sector, with those affecting gas transportation or distribution, the Tribunal can only conclude that the Argentine Government discriminated against the gas distribution and transportation sectors. The alleged discrimination is particularly obvious in Claimants' view by the fact that most of the investors in the gas-distribution sector are foreigners.
144. Respondent argues that the measures it adopted were not discriminatory because they were general measures without any unreasonable distinction. Respondent questions whether Argentina's measures can be considered discriminatory, if one acknowledges, as Claimants have, that other industries related to public services were affected by the measures adopted regarding the PPI (Respondent's Counter-Memorial, ¶ 700).
145. Respondent explains that each public service is regulated by its own set of tariff rules, and for that reason, the effect may not have been exactly the same for all sectors, including the field of public services. Respondent alleges that "[i]t is irrational and illegitimate to compare one utility to a different one, subject to different rules, different agreements and different characteristics, and then hold that it is discriminatory to treat differently the different utilities at stake" (Respondent's Counter-Memorial, ¶ 703, emphasis omitted).

**(ii) Tribunal's Analysis**

146. In the context of investment treaties, and the obligation thereunder not to discriminate against foreign investors, a measure is considered discriminatory if the intent of the measure is to discriminate or if the measure has a discriminatory effect.<sup>40</sup> As stated in the *ELSI Elettronica*

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<sup>40</sup> See Vandevelde, Kenneth J., *United States Investment Treaties: Policy and Practice*, Kluwer Law



*Sicula SpA case (United States of America v. Italy)*, ICJ Report 1989 RLA 56 at 61-62 (20 July 1989), in order to establish when a measure is discriminatory, there must be (i) an intentional treatment (ii) in favor of a national (iii) against a foreign investor, and (iv) that is not taken under similar circumstances against another national.

**(iii) Tribunal's Conclusion**

147. While the Tribunal concludes that based on the evidence presented, Respondent treated the gas-distribution companies in a discriminatory manner, imposing stricter measures on the gas-distribution companies than other public-utility sectors, Claimants have however not proven that these measures targeted Claimants' investments specifically as foreign investments.
  
148. Certainly, all the gas-distribution companies were affected by the economic crisis and by the Government's measures like all other companies within the public-utility sector. However, Argentina suspended PPI adjustments for the gas industry two years before enacting the Emergency Law. It did not take the same action with respect to the public-utility companies such as the electricity and water distribution companies, in which case it continued to adjust their tariffs until enactment of the Emergency Law. Instead, the gas-distribution companies were subjected to unfavorable regimes devised for the conversion of dollar obligations and tariffs into pesos. Even though it was not proved that these measures had been adopted with the purpose of causing Claimants' foreign investments damage, discrimination against gas distribution companies vis-à-vis other companies, such as water supply and electricity companies, is evident.

2. **Arbitrary Treatment**

(i) **Parties' Positions**

149. Claimants characterize Argentine Government's course of conduct towards the gas-distribution licensees as arbitrary in violation of Article II(2)(b) of the Bilateral Treaty. Claimants articulate the standard for what constitutes an "arbitrary" act as "disregard for the rule of law" (Claimants' Memorial, ¶ 176).
150. Claimants argue that, in taking measures against the gas-distribution licensees and other public utilities, the Argentine Government acted in disregard for the rule of law. According to Claimants, the Government acted under the trappings of laws, decrees, resolution, regulations and court decisions, but by willfully repudiating the commitments it made to the gas-distribution licensees and their shareholders, the Government followed "the rule of power, not the rule of law" (Claimants' Post-Hearing Brief, ¶ 44). In Claimants' view, the Government's wholesale repudiation of the tariff system was unnecessary to achieve the stated aims of the PPI suspension or those of the Emergency Law, since the the tariff system was sufficiently flexible to allow Respondent to reduce tariffs unilaterally, for any reason, as long as it paid compensation to the licensees. Instead, the Government chose to dismantle the whole tariff system without granting due compensation (Claimants' Memorial, ¶ 176).
151. Claimants argue that when Respondent's Bilateral Treaty obligations and the promises made to the foreign investors became politically and economically inconvenient, Respondent ignored its obligations and repudiated the Gas Law's key provisions. These measures, they assert, not only surprise but also contradict any sense of Respondent's ownership of its legal obligations, and accordingly they are arbitrary in nature. Claimants refute as without evidence any assertion by Respondent that if the guarantees had not been abolished, tariffs would have tripled or quadrupled in price (Claimants' Post-

Hearing Brief, ¶ 44).

152. In its defense, Respondent contends that the measures were not arbitrary; on the contrary, they were reasonable and proportionate to the end pursued. In Argentina's view, the tariff system was not dismantled. Rather, it was modified by the measures that the Government was forced to put in place during the economic crisis. Respondent suggests that under the circumstances, the deferment of the PPI adjustment in the year 2000 was a reasonable measure. This position, as Respondent views it, is supported by both a decision of a court of first instance and by the Federal Court of Appeal (Cámara Federal de Apelaciones), which concluded that the adjustment at issue was unreasonable within the recessive economic context endured by the Argentine Republic. The stability that Claimants argue should characterize the legal system does not mean that the system will exist in perpetuity, immutability or immobility. Any requirement of "freezing the law" without considering the social and economic circumstances under which the laws were enacted, is transforming the Argentine legal system into a "frivolous rite" (Respondent's Counter-Memorial, ¶¶ 638-639).
153. Respondent contends that linking the tariff adjustments to the peso (pesificación) is not arbitrary or discriminatory. Had there been no link to the peso, many customers could not have had access to the gas service, which would have resulted in the collapse of the distribution industries themselves, and tariffs would have been no longer fair but abusive.
154. In Respondent's view, none of the measures adopted by the Argentine Government may be qualified as arbitrary or discriminatory. On the contrary, they were proportionate and reasonable under the circumstances and accordingly, not a violation of Article II(2)(b) of the Bilateral Treaty (Respondent's Post-Hearing Brief, ¶ 112).

**(ii) Tribunal's Analysis**

155. Article II(2)(b) of the Bilateral Treaty provides that "[n]either Party shall in

any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments.”

156. The term “arbitrary” is left undefined by the Bilateral Treaty. Thus, the Tribunal looks to its plain meaning for international law to determine whether the measures adopted by Argentina could be classified as arbitrary.
157. According to international law, arbitrariness has been described as “a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety.”<sup>41</sup> The tribunal in *Ronald S. Lauder v. The Czech Republic*, referring to the Black’s Law Dictionary, defined the term as “depending on individual discretion; (...) founded on prejudice or preference rather than on reason or fact.”<sup>42</sup>
158. It is apparent from the Bilateral Treaty that Argentina and the United States wanted to prohibit themselves from implementing measures that affect the investments of nationals of the other Party without engaging in a rational decision-making process. Such process would include a consideration of the effect of a measure on foreign investments and a balance of the interests of the State with any burden imposed on such investments. Certainly a State that fails to base its actions on reasoned judgment, and uses abusive arguments instead, would not “stimulate the flow of private capital.”<sup>43</sup>
159. The *Genin* case quoted by Respondent provides a good example of a State measure upholding a guarantee similar to the prohibition in the Estonia – U.S. BIT against arbitrary treatment. There, the tribunal concluded that the Bank of Estonia’s annulment of a license occurred in the course of

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<sup>41</sup> *Eletronica Sicula S.p.A. (ELSI) (United States of America v. Italy)*, 1989 I.C.J. 15, 76 (Judgment of 20 July).

<sup>42</sup> *Ronald S. Lauder v. The Czech Republic*, Final Award ¶ 221 (3 September 2001) (citing Black’s Law Dictionary 100 (7<sup>th</sup> ed. 1999)).

<sup>43</sup> Preamble, Argentina – U.S. BIT (1994).

exercising its statutory obligations to regulate the Estonian banking sector, and therefore was not arbitrary.<sup>44</sup> In so concluding, the tribunal accepted Estonia's explanation that the circumstances of political and economic transition prevailing in Estonia at the time justified heightened scrutiny of the banking sector, and that such regulation by a State reflects "a clear and legitimate public purpose."<sup>45</sup>

160. In contrast, the *Lauder* tribunal determined that the acts of the Czech Republic's Media Council were arbitrary. Such acts consisted in forcing a private investor in the newly-privatized company that held the state television license to exchange a direct participation in the company for a contractual relationship.<sup>46</sup> The tribunal reasoned that the act was motivated by fear of the political implications of having a foreigner influencing Czech television broadcasts.<sup>47</sup>

**(iii) Tribunal's Conclusion**

161. This case lands between the two cases mentioned above, but ultimately the Tribunal concludes that the acts of Argentina were not arbitrary, and therefore did not violate Article II(2)(b) for the following reasons.
162. While Claimants have alleged Argentina's political motivation to use foreign investors in the public utility sector as an excuse to justify the economic mistakes committed in the country, Argentina has explained that the Government's motivation was its desire to avoid its full economic collapse. To this end, it entered into agreements with the licensees in 2001, in addition to other actions taken. Bearing in mind the Tribunal's analysis, characterizing the measures as not arbitrary does not mean that such measures are characterized as fair and equitable or regarded as not having

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<sup>44</sup> *Genin*, ¶ 370.

<sup>45</sup> *Ibidem*.

<sup>46</sup> *Lauder*, ¶ 222-32.

affected the stability of the legal framework under which gas transportation companies in Argentina operated. On the contrary, this means that Argentina faced severe economic and social hardships from 2001 onwards and had to react to the circumstances prevailing at the time. Even though the measures adopted by Argentina may not have been the best, they were not taken lightly, without due consideration. This is particularly reflected in the PPI adjustments which, before deciding on their postponement, Argentina negotiated with the investors. The Tribunal concludes that the charges imposed by Argentina to Claimants' investment, though unfair and inequitable, were the result of reasoned judgment rather than simple disregard of the rule of law.

163. Likewise, it was not arbitrary, though unfair and inequitable, not to restore the Gas Law or the other guarantees related to the gas distribution sector and to implement the contract renegotiation policy.

### **C. ARTICLE II(2)(c): THE UMBRELLA CLAUSE**

#### **1. Parties' Positions**

164. LG&E claims that Argentina violated Article II(2)(c) of the BIT when it assumed certain fundamental obligations with regard to investments in its gas-distribution sector and the foreign investors and then repudiated each of these legal commitments without compensating Claimants for their loss.
165. As LG&E explains it, Argentina used foreign capital investment as the cornerstone of its economic recovery plan in the early 1990s. Respondent designed the privatization of *Gas del Estado S.E.* as an international bidding process, in which the conditions for bidding on local enterprises could be met only by a consortium involving foreign investors. Argentina wooed foreign investors with promises of return on investment that would always

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<sup>47</sup> *Lauder*, ¶¶ 229, 232.

be reasonable, protections against currency exchange and inflation, adjustment of rates pursuant to international indexes, no unilateral changes and no price controls without indemnification. Argentina bound itself to these promises in the form of legal obligations.

166. According to Claimants, these are the promises that the umbrella clause is meant to address. The Tribunal need not decide that every commitment regarding investments embodied in general legislation or regulations gives rise to obligations that must be observed under that clause. Rather, liability derives from this article of the Treaty when in the particular circumstances of this case, Respondent failed to observe its obligations.
167. The problem with LG&E's claim, according to Respondent, is that it assumes that general legislation relating to the natural gas distribution and transportation industry falls within Article II(2)(c)'s parameter. Respondent suggests that such promises do not qualify as specific representations that make the umbrella clause effective.
168. Respondent also asserts that LG&E's claims are nothing more than claims of contractual breaches, which are to be considered under the specific jurisdictional clauses of the contract and not adjudicated in an international forum under application of the umbrella clause.

## **2. Tribunal's Analysis**

169. Article II(2)(c) of the Treaty provides that "[e]ach party shall observe any obligation it may have entered into with regard to investments."
170. Such clause, referred to as an "umbrella clause," is a general provision included in a fairly large number of bilateral treaties that creates a requirement for the host State to meet its obligations towards foreign investors, including those that derive from a contract. Hence such obligations receive extra protection by virtue of their consideration under the bilateral treaty.

171. In many cases it has been considered that the umbrella clause is activated not by obligations set forth in municipal law, but in contracts between the State and the investor.<sup>48</sup> Several of those tribunals have concluded that the breach of a contractual obligation in a contract between the State and the investor gives rise to a claim under the umbrella clause.<sup>49</sup>
172. The issue for the Tribunal's consideration is whether the provisions of the Gas Law and its implementing regulations constitute (i) "obligations" (ii) "with regard to" LG&E's capacity as a foreign investor (iii) with respect to its "investment," such that abrogation of the guarantees set forth in the Gas Law and its implementing regulations give rise to a violation of the Treaty.
173. In this case, it will be necessary to establish whether LG&E's claims fall under the umbrella clause's protection.
174. In order to determine the applicability of the umbrella clause, the Tribunal should establish if by virtue of the provisions of the Gas Law and its regulations, the Argentine State has assumed international obligations with respect to LG&E and its investment. To this end, it is necessary to remember that the provisions of the Gas Law and its regulation fixed and regulated the tariff scheme ensuring the value of Claimants' investment; that the purpose of Claimants' investment was to increase the value of its shares in the Licensees through a fragile balanced management of profits and costs, represented by the tariffs fixed by Argentina in light of the already mentioned Gas Law and its regulation. In view of the statements above, the Tribunal concludes that these provisions were not legal obligations of a general nature.<sup>50</sup> On the contrary, they were very specific in relation to

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<sup>48</sup> See e.g., *CMS*, ¶300 (citing cases).

<sup>49</sup> *CMS*, ¶ 303; *SGS v. Republic of the Philippines*, Decision on Jurisdiction, ICSID Case No. ARB/02/6 (29 January 2004), ¶¶ 127-28.

<sup>50</sup> *SGS v. Philippines*, ¶ 121 ("For [the umbrella clause] to be applicable, the host State must have assumed a legal obligation, and it must have been assumed vis-à-vis the specific investment – not as a matter of the application of some legal obligation of a general character.").



LG&E's investment in Argentina, so that their abrogation would be a violation of the umbrella clause.

**3. Tribunal's Conclusion**

175. As such, Argentina's abrogation of the guarantees under the statutory framework – calculation of the tariffs in dollars before conversion to pesos, semi-annual tariff adjustments by the PPI and no price controls without indemnification – violated its obligations to Claimants' investments. Argentina made these specific obligations to foreign investors, such as LG&E, by enacting the Gas Law and other regulations, and then advertising these guarantees in the Offering Memorandum to induce the entry of foreign capital to fund the privatization program in its public service sector. These laws and regulations became obligations within the meaning of Article II(2)(c), by virtue of targeting foreign investors and applying specifically to their investments, that gave rise to liability under the umbrella clause.

**D. CONSIDERATIONS ON INDIRECT EXPROPRIATION**

**1. Parties' Positions**

176. LG&E seeks a declaration from this Tribunal that Argentina expropriated LG&E's investment in the Argentine gas-distribution sector without compensation in violation of Article IV of the Treaty, which provides, in part:

“1. Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization (“expropriation”) except for a public purpose; in a non-discriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law and the general principles of treatment provided for in Article II(2).”

177. LG&E articulates its expropriation claim as one of indirect expropriation. In other words, LG&E argues that the Argentine Government's treatment of Claimants' investment in the Licensees constitutes an indirect expropriation

of the investments because the value of LG&E's holdings in the Licenses has been reduced by more than 90% as a result of Respondent's abrogation of the principal guarantees of the tariff system (Claimants' Memorial, ¶ 180).

178. LG&E contends that, pursuant to Article IV of the Bilateral Treaty, it is entitled to compensation equivalent to the fair market value of the expropriated investment immediately before the expropriation was committed. Claimants pinpoint the date of expropriation in this case as the date on which Respondent's course of conduct finally resulted in the virtual destruction of the value of the investment –not later than August 2000, when the Argentine court enjoined implementation of the 17 July 2000 agreement and any further PPI adjustments (Claimants' Memorial, ¶ 181).
179. Under Claimants' theory, indirect expropriation occurs when government action substantially impairs the value of an investment (Claimants' Post-Hearing Brief, ¶ 53 *citing* Dolzer Reb., ¶ 56). In this case, the Claimants consider that the Argentine Government's actions had a substantial effect on LG&E's shares in the Licensees, which are an investment protected under Article I(1)(a) of the Treaty. The value of LG&E's investment was based on a tariff system and depended on the Respondent respecting the system. The value of LG&E's shares in the Licensees now fluctuates according to general speculation around the future tariff relief that Argentina may or may not grant (Claimants' Post-Hearing Brief, ¶ 53).
180. Claimants add that when it comes to establishing whether there was effectively an indirect expropriation, there is no relevance to the fact that the Licensees continue to operate or control their gas-distribution business, or as to whether Claimants hold title to the shares. In the case of indirect expropriation, it does not matter whether title to the licenses has been transferred to the State. It is enough to show that their investment has been impaired as a result of government action, which they claim is the case here as there allegedly has been a substantial appropriation of value by the State and transfer of wealth from the gas industry to gas consumers, especially

large industrial consumers (Claimants' Post-Hearing Brief, ¶¶ 53-54).

181. The Respondent denies that any expropriation under Article IV of the Bilateral Treaty has occurred. Respondent contends that, in order for the Argentine Government to have either directly or indirectly expropriated Claimants' investment, the measures at issue would have had to have been designed to transfer title to the investment to the State. The sole difference between direct and indirect expropriation in this case, according to Respondent, is that with indirect expropriation, no formal transfer of title is required, since its purpose is that of "masking, disguising the expropriating event and of eluding the resulting liability" (Respondent's Post-Hearing Brief, ¶ 103).
182. Respondent argues that Claimants have not proven that the PPI's suspension constitutes an expropriating event. Respondent contends that the suspension of the PPI adjustments would have affected tariffs by approximately 2%, and states that under no circumstance could a tribunal conclude that such a small loss qualifies as an expropriation subject to compensation.
183. Argentina argues that in any event there could not have been any expropriation during the economic crisis. The fact that the licensees may have been affected by the crisis, along with everyone else, does not lead to the conclusion that their investment was expropriated. Respondent denies any causal link between the measures adopted by the Argentine State during this time and the fluctuations in the value of LG&E's shares in the licensees. In its opinion, the fluctuation in the value of LG&E's investment is attributable to the "macroeconomic conditions affecting the Argentine Republic", rather than the measures adopted by the Argentine State (Respondent's Post-Hearing Brief, ¶ 109). Argentina points out that between 1997 and 2000, LG&E earned higher income than expected through its investments in the licensees.
184. Finally, after objecting the expropriation claim because the company

remains de facto and by law the owner of the investment, Respondent alleges that, in fact, the share prices of Claimants' investment have increased in value from the period immediately preceding the suspension of the PPI adjustments. As such, Respondent argues that where property is worth more today than it was prior to the measures' adoption, the property may not be deemed expropriated (Respondent's Post-Hearing Brief, ¶¶ 110-111).

## **2. Tribunal's Analysis**

185. In order to establish the sustainability of an indirect expropriation, the Tribunal must define the concept. Generally, bilateral treaties do not define what constitutes an expropriation –they just make an express reference to “expropriation” and add the language “any other action that has equivalent effects.” Likewise, Article IV of the Bilateral Treaty does not define the term “expropriation” and does not establish which measures, actions or conduct would constitute acts “tantamount to expropriation.” Therefore, the Tribunal shall look to international law in determining the relevant criteria for evaluating this claim.
186. A State may, at its discretion, under Article IV of the Bilateral Treaty and in accordance with general principles of international law, make use of its sovereign power to expropriate private property with the purpose of satisfying a public interest. However, expropriation in any of its modalities requires due process and compensation under international law.
187. Although in scholarly authority two kinds of expropriation are known, we will obviously skip the direct one, understood as the forcible appropriation by the State of the tangible or intangible property of individuals by means of administrative or legislative action. The parties admit that the claim at issue does not involve a direct expropriation. In the case of the Argentine Republic, one could not say that it appropriated Claimants' investment, which is the indispensable requirement if one is to talk of direct expropriation. Instead, we shall limit ourselves to the assumption of the

indirect expropriation, one qualified by the Bilateral Treaty itself as “measures tantamount to expropriation.”

188. Generally, the expression “equivalent to expropriation” or “tantamount to expropriation” found in most bilateral treaties, may refer both, to the so-called “creeping expropriation” and to the *de facto* expropriation. Their common point rests in the fact that the host State’s actions or conduct do not involve “overt taking” but the taking occurs when governmental measures have “effectively neutralize[d] the benefit of property of the foreign owner.”<sup>51</sup> Ownership or enjoyment can be said to be “neutralized” where a party no longer is in control of the investment, or where it cannot direct the day-to-day operations of the investment.<sup>52</sup> As to the differences, it is usual to say that indirect expropriation may show itself in a gradual or growing form—creeping expropriation— or through a sole and unique action, or through actions being quite close in time or simultaneous—*de facto* expropriation.
189. In order to establish whether State measures constitute expropriation under Article IV(1) of the Bilateral Treaty, the Tribunal must balance two competing interests: the degree of the measure’s interference with the right of ownership and the power of the State to adopt its policies.
190. In evaluating the degree of the measure’s interference with the investor’s right of ownership, one must analyze the measure’s economic impact – its interference with the investor’s reasonable expectations – and the measure’s duration.
191. In considering the severity of the economic impact, the analysis focuses on whether the economic impact unleashed by the measure adopted by the host State was sufficiently severe as to generate the need for compensation due to expropriation. In many arbitral decisions, the compensation has been denied

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<sup>51</sup> *CME Czech Republic v. Czech Republic*, Partial Award, ¶ 604 (13 September 2001).

when it has not affected all or almost all the investment's economic value. Interference with the investment's ability to carry on its business is not satisfied where the investment continues to operate, even if profits are diminished.<sup>53</sup> The impact must be substantial in order that compensation may be claimed for the expropriation.

192. The tribunal in *Tecmed* required a finding that Claimant had been “radically deprived of the economical use and enjoyment of its investments, as if the rights related thereto –such as the income or benefits related to the [investment...]- had ceased to exist.”<sup>54</sup> In other words, if due to the actions of the Respondent, the assets involved have lost their value or economic use for the Claimants and the extent of the loss.<sup>55</sup>
193. Similarly, one must consider the duration of the measure as it relates to the degree of interference with the investor's ownership rights. Generally, the expropriation must be permanent, that is to say, it cannot have a temporary nature, unless the investment's successful development depends on the realization of certain activities at specific moments that may not endure variations.
194. There is no doubt that the facts relating to the severity of the changes on the legal status and the practical impact endured by the investors in this case, as well as the possibility of enjoying the right of ownership and use of the investment are decisive in establishing whether an indirect expropriation is said to have occurred. The question remains as to whether one should only take into account the effects produced by the measure or if one should consider also the context within which a measure was adopted and the host State's purpose. It is this Tribunal's opinion that there must be a balance in

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<sup>52</sup> *Pope & Talbot Inc. v. Canada*, Interim Award, ¶ 100 (26 June 2000).

<sup>53</sup> *Pope & Talbot*, ¶¶ 101-02.

<sup>54</sup> *Tecmed*, ¶ 115.

<sup>55</sup> *Ibidem*.

the analysis both of the causes and the effects of a measure in order that one may qualify a measure as being of an expropriatory nature. It is important not to confound the State's right to adopt policies with its power to take an expropriatory measure. "This determination is important because it is one of the main elements to distinguish, from the perspective of an international tribunal between a regulatory measure, which is an ordinary expression of the exercise of the state's police power that entails a decrease in assets or rights, and a *de facto* expropriation that deprives those assets and rights of any real substance."<sup>56</sup>

195. With respect to the power of the State to adopt its policies, it can generally be said that the State has the right to adopt measures having a social or general welfare purpose. In such a case, the measure must be accepted without any imposition of liability, except in cases where the State's action is obviously disproportionate to the need being addressed. The proportionality to be used when making use of this right was recognized in *Tecmed*, which observed that "whether such actions or measures are proportional to the public interest presumably protected thereby and the protection legally granted to investments, taking into account that the significance of such impact, has a key role upon deciding the proportionality."<sup>57</sup>
196. As is observed by *The American Law Institute's Restatement (Third) of the Foreign Relations Law of the United States*, "a state is not responsible for loss of property or for other economic disadvantage resulting from *bona fide* general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of the states, if it is not discriminatory..."<sup>58</sup>. This criterion was used by the Tribunal of Iran-United

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<sup>56</sup> *Ibidem*.

<sup>57</sup> *Tecmed*, ¶122.

<sup>58</sup> *Restatement (Third) of the Foreign Relations Law of the United States*, American Law Institute,

States of America claims in the *Too v. Greater Modesto Insurance Associates*.<sup>59</sup>

197. As was stated in the *Oscar Chinn* affair of 1934, adopted by the Permanent Court of International Justice:

“No enterprise... can escape from the chances and hazards resulting from general economic conditions. Some industries may be able to make large profits during a period of general prosperity, or else by taking advantages of a treaty of commerce or of an alteration in customs duties; but they are also exposed to the danger of ruin or extinction if circumstances change. Where this is the case, no vested rights are violated by the State.”<sup>60</sup>

### **3. Tribunal’s Conclusion**

198. In the circumstances of this case, although the State adopted severe measures that had a certain impact on Claimants’ investment, especially regarding the earnings that the Claimants expected, such measures did not deprive the investors of the right to enjoy their investment. As in *Pope & Talbot*, the true interests at stake here are the investment’s asset base, the value of which has rebounded since the economic crisis of December 2001 and 2002.
199. Further, it cannot be said that Claimants lost control over their shares in the licensees, even though the value of the shares may have fluctuated during the economic crisis, or that they were unable to direct the day-to-day operations of the licensees in a manner different than before the measures were implemented.
200. Thus, the effect of the Argentine State’s actions has not been permanent on the value of the Claimants’ shares’, and Claimants’ investment has not ceased to exist. Without a permanent, severe deprivation of LG&E’s rights

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Volume 1, 1987, Section 712, Comment g.

<sup>59</sup> *Too v. Greater Modesto Insurance Associates*, 23 Iran-United States Cl. Trib. Rep. 378, Award of 29 December 1989.

<sup>60</sup> *Oscar Chinn* affair, P.C.I.J., 1934, Ser A/B, Case No. 63.



with regard to its investment, or almost complete deprivation of the value of LG&E's investment, the Tribunal concludes that these circumstances do not constitute expropriation.

## **E. STATE OF NECESSITY**

### **1. Parties' Positions**

201. Respondent contends in the alternative that, if Argentina would have breached its Treaty obligations, the state of political, economic and social crisis that befell Argentina allowed it to take action contrary to the obligations it had assumed with respect to the gas-distribution licensees. Thus, even if the measures adopted by the State in order to overcome the economic crisis suffered during the years 1998 through 2003, resulted in a violation of the rights guaranteed under the Treaty to foreign investments, such measures were implemented under a state of necessity and therefore, Argentina is excused from liability during this period.
202. Respondent pleads its defense as a "state of necessity" defense, available under Argentine law, Treaty in Articles XI and IV(3), as well as customary international law.
203. Claimants reject Respondent's contentions regarding the alleged state of necessity defense. Claimants contend that Article XI is not applicable in the case of an economic crisis because the public order and essential security interests elements are intentionally narrow in scope, limited to security threats of a physical nature.

### **2. General Comments on Article XI**

#### **(i) Preliminary Considerations**

204. Article XI of the Bilateral Treaty provides:

"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.”

205. The Tribunal’s analysis to determine the applicability of Article XI of the Bilateral Treaty is twofold. First, the Tribunal must decide whether the conditions that existed in Argentina during the relevant period were such that the State was entitled to invoke the protections included in Article XI of the Treaty. Second, the Tribunal must determine whether the measures implemented by Argentina were necessary to maintain public order or to protect its essential security interests, albeit in violation of the Treaty.<sup>61</sup>
206. The Tribunal reiterates that to carry out the two-fold analysis already mentioned, it shall apply first, the Treaty, second, the general international law to the extent that is necessary and third, the Argentine domestic law. The Tribunal underscores that the claims and defenses mentioned derive from the Treaty and that, to the extent required for the interpretation and application of its provisions, the general international law shall be applied (See section V. B *supra*).

**(ii) The Question of Whether Article XI is Self-Judging**

207. Before turning to its substantive analysis of Article XI, the Tribunal must determine whether Article XI is *self-judging*.
208. Respondent has argued that because Article XI is a self-judging provision, it is for the State to make a good faith determination as to what measures are necessary for the maintenance of public order, or the protection of its essential security interests. According to Respondent, under this self-judging exception, the Tribunal must decide only whether Argentina acted in good faith or not.

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<sup>61</sup> Respondent has not relied upon the third element of Article XI, “the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security.”

209. Respondent considers Article XI is ambiguous and characterizes such ambiguity as a “strategic ambiguity” on the part of the United States, since it does not clearly define who should determine if the measures to maintain public order or protect essential security interests are necessary. Respondent recognizes that the United States’ 1987 Model BIT, upon which the Argentina–U.S. BIT was based, does not clarify the United States’ position, nor does any of the documentation related to the negotiation or ratification of the Argentina-U.S. BIT. However, Respondent contends that subsequent to the conclusion of the Argentina-U.S. BIT, the United States shifted its position permanently with regard to essential security clauses, stating in 1992 that the United States considered such clauses to be self-judging, presently and retroactively (Slaughter Witness Statement, ¶¶ 12-31).
210. Claimants disagree that Article XI is self-judging, and argue instead that its application requires that the Tribunal conduct its own analysis of whether the conditions necessitated measures to maintain public order or protect Argentina’s essential security interests within the meaning of Article XI.
211. Claimants contend that neither the plain meaning of Article XI, nor the context or purpose of the Treaty suggest that Article XI is self-judging, and that the position of the United States at the time the parties signed the Treaty was that such clauses were not self-judging (Hearing on the Merits, 28 January 2005, Alvarez, Spanish Transcript, p. 925 *et seq.*). Claimants argue that Respondent has not proven that the parties to the Treaty intended Article XI to be self-judging, which they characterize as “an exceptional thing.” (Hearing on the Merits, 28 January 2005, Alvarez, Spanish Transcript, p. 932 *et seq.*). Claimants contend that the United States did not consider essential security clauses as self-judging until the Russia-U.S. BIT of 1992 and the 1992 U.S. Model BIT, both of which post-date the Argentina-U.S. BIT, and both of which noted explicitly the change in the United States’ policy that these provisions were to be self-judging.
212. Certainly, the language of the BIT does not specify who should decide what

constitutes essential security measures –either Argentina itself, subject to a review under a good faith standard, or the Tribunal. Based on the evidence before the Tribunal regarding the understanding of the Parties in 1991 at the time the Treaty was signed, the Tribunal decides and concludes that the provision is not self-judging.

213. The provisions included in the international treaty are to be interpreted in conformity with the interpretation given and agreed upon by both parties at the time of its signature, unless both parties agreed to its modification. In that case, the date to be considered is November 1991. It is not until 1992, with the ratification of the Russia – US BIT, that the United States begins to consider that the application of the essential security measures are *self judging*; both instruments post-date the bilateral treaty between the United States and the Argentine Republic and, in both cases, this change was explicitly clarified.
214. Were the Tribunal to conclude that the provision is self-judging, Argentina’s determination would be subject to a good faith review anyway, which does not significantly differ from the substantive analysis presented here.

**(iii) Necessary Nature of the Measures Adopted**

**a. Parties’ Positions**

215. Argentina defends the measures it implemented as necessary to maintain public order and protect its essential security interests. It contends that under any interpretation, the financial crisis, riots and chaos of the years 2000 through 2002 in Argentina constitute a national emergency sufficient to invoke the protections of Article XI (Slaughter Witness Statement, ¶ 45).
216. Concerning “public order”, Respondent reinforces its arguments on the necessary nature of the measures it had implemented by pointing to numerous reports of waves of sudden economic catastrophe, massive strikes involving millions of workers, fatal shootings, the shut down of schools,

businesses, transportation, energy, banking and health services, demonstrations across the country, and a plummeting stock market, culminating in a “final massive social explosion” in which five presidential administrations resigned within a month (Slaughter Witness Statement, ¶¶ 46-49). Under these circumstances, Argentina argues that price controls by the Argentine Government would have been fully justifiable under the public order provisions of Article XI. Additionally, Respondent argues that actions to freeze price increases in the gas-distribution sector were justifiable to maintain the country’s basic infrastructure, which was dependent on natural gas energy.

217. Argentina also defends its measures as necessary to protect its essential security interests. Argentina asserts that Article XI’s “essential security interests” element encompasses economic and political interests, as well as national military defense interests. Respondent cites several United States’ officials who have propounded a broad interpretation of “essential security interests” (Slaughter Witness Statement, ¶ 38).
218. Respondent attacks Claimants’ basis for asserting that the clause is narrow, reserved only for military actions. Furthermore, in all of the cases cited by Claimants, the point was whether the use of military force was justifiable under international law – a narrow reading of essential security clauses in these cases would be expected.
219. Because economic stability, in Respondent’s view, falls within a State’s essential security interests, Respondent defends the measures it took as necessary to protect its economic interests. Respondent argues that during the crisis period, the health, safety and security of the Argentine State and its people were threatened, and that the economic melt-down had the potential to cause catastrophic state failure. Thus, the public emergency that Argentina declared and the Emergency Law the Government passed altering its financial arrangements were necessary to protect the State’s essential security interests.

220. Claimants identify the four measures at issue here –suspension and abolishment of the PPI adjustment, freezing the gas-distribution tariffs, and abandonment of the calculation of the tariffs in dollars, all taken unilaterally– and contend that Respondent must prove that each measure was necessary in order to maintain public order and protect Argentina’s essential security interests (Reply, ¶ 209). By the term “necessary,” Claimants contend that these measures must have been the only option available to Argentina in order to invoke protection under Article XI.
221. Claimants define public order measures as “actions taken pursuant to a state’s police powers, particularly in respect of public health and safety”. Based on this definition, Claimants state that the measures in dispute in this case were not aimed at bringing calmness to the collapse that was threatening the country. Consequently, such measures cannot be deemed necessary to maintain public order.
222. With respect to “essential security interests,” Claimants reiterate that such interests do not include economic interests –only defense or military concerns. They compare a State’s interest in essential security to a national security threat, while a “national emergency,” the alleged circumstance in which Respondent invokes the protection, has an entirely different meaning. In Claimants’ view, economic crises should not be elevated to an essential security interest, and that doing so would disregard the object and purpose of the Treaty. They argue that an economic crisis is precisely when investors need the protections offered by a BIT.
223. Claimants argue that in any event, Article XI does not relieve Argentina of its obligations to compensate Claimants for damages suffered as a result of breaches of the Treaty.
224. Claimants also reject the possibility of applying the rule provided by Article IV(3) of the Treaty. They are of the opinion that this provision does not apply to economic crises, and it does not authorize the host State to revoke

or suspend the protections given to foreign investors (Reply, ¶ 229).

225. Claimants invoke Article 27 of the International Law Commission’s Draft Articles on State Responsibility. Claimants contend that even if the state of necessity defense is available to Argentina under the circumstances of this case, Article 27 of the Draft Articles makes clear that Argentina’s obligations to Claimants are not extinguished and Argentina must compensate Claimants for losses incurred as a result of the Government’s actions. Article 27 provides that “invocation of a circumstance precluding wrongfulness in accordance with this chapter is without prejudice to (a) compliance with the obligation in question... (b) the question of compensation for any material loss caused by the act in question” (Reply, ¶¶ 226-228).

**b. Tribunal’s Analysis**

226. In the judgment of the Tribunal, from 1 December 2001 until 26 April 2003, Argentina was in a period of crisis during which it was necessary to enact measures to maintain public order and protect its essential security interests.
227. The Tribunal does not consider that the initial date for the state of necessity is the effective date of the Emergency Law, 6 January 2002, because, in the first place, the emergency had already started when the law was enacted. Second, should the Tribunal take as the initial date the day when the Emergency Law became effective, it might be reasonable to take as its closing date the day when the state of emergency is lifted by the Argentine State, a fact that has not yet taken place since the law has been extended several times.
228. It is to be pointed out that there is a factual emergency that began on 1 December 2001 and ended on 26 April 2003, on account of the reasons detailed below, as well as a legislative emergency, that begins and ends with the enactment and abrogation of the Emergency Law, respectively. It should be borne in mind that Argentina declared its state of necessity and has

extended such state until the present. Indeed, the country has issued a record number of decrees since 1901, accounting for the fact that the emergency periods in Argentina have been longer than the non-emergency periods. Emergency periods should be only strictly exceptional and should be applied exclusively when faced with extraordinary circumstances. Hence, in order to allege state of necessity as a State defense, it will be necessary to prove the existence of serious public disorders. Based on the evidence available, the Tribunal has determined that the situation ended at the time President Kirchner was elected.

229. Thus, Argentina is excused under Article XI from liability for any breaches of the Treaty between 1 December 2001 and 26 April 2003. The reasons are the following:
230. These dates coincide, on the one hand, with the Government's announcement of the measure freezing funds, which prohibited bank account owners from withdrawing more than one thousand pesos monthly and, on the other hand, with the election of President Kirchner. The Tribunal marks these dates as the beginning and end of the period of extreme crisis in view of the notorious events that occurred during this period.
231. Evidence has been put before the Tribunal that the conditions as of December 2001 constituted the highest degree of public disorder and threatened Argentina's essential security interests. This was not merely a period of "economic problems" or "business cycle fluctuation" as Claimants described (Claimants' Post-Hearing Brief, ¶ 14). Extremely severe crises in the economic, political and social sectors reached their apex and converged in December 2001, threatening total collapse of the Government and the Argentine State.
232. All of the major economic indicators reached catastrophic proportions in December 2001. An accelerated deterioration of Argentina's Gross Domestic Product (GDP) began in December 2001, falling 10 to 15 percent faster than



the previous year. Private consumption dramatically dropped in the fourth quarter of 2001, accompanied by a severe drop in domestic prices. Argentina experienced at this time widespread decline in the prices and in the value of assets located in Argentina. The Merval Index, which measures the share value of the main companies of Argentina listed on the Buenos Aires Stock Exchange, experienced a dramatic decline of 60% by the end of December 2001. By mid-2001, Argentina's country risk premium was the highest premium worldwide, rendering Argentina unable to borrow on the international markets, and reflecting the severity of the economic crisis.

233. At this time, capital outflow was a critical problem for the Government. In the fourth quarter of 2001, the Central Bank of Argentina lost US\$ 11 billion in liquid reserves, amounting to 40%. The banking system lost 25% of its total deposits.
234. While unemployment, poverty and indigency rates gradually increased from the beginning of 1998, they reached intolerable levels by December 2001. Unemployment reached almost 25%, and almost half of the Argentine population was living below poverty. The entire healthcare system teetered on the brink of collapse. Prices of pharmaceuticals soared as the country plunged deeper into the deflationary period, becoming unavailable for low-income people. Hospitals suffered a severe shortage of basic supplies. Investments in infrastructure and equipment for public hospitals declined as never before. These conditions prompted the Government to declare the nationwide health emergency to ensure the population's access to basic health care goods and services. At the time, one quarter of the population could not afford the minimum amount of food required to ensure their subsistence. Given the level of poverty and lack of access to healthcare and proper nutrition, disease followed. Facing increased pressure to provide social services and security to the masses of indigent and poor people, the Government was forced to decrease its per capita spending on social services by 74%.

235. By December 2001, there was widespread fear among the population that the Government would default on its debt and seize bank deposits to prevent the bankruptcy of the banking system. Faced with a possible run on banks, the Government issued on 1 December 2001 Decree of Necessity and Emergency No. 1570/01. The law triggered widespread social discontent. Widespread violent demonstrations and protests brought the economy to a halt, including effectively shutting down transportation systems. Looting and rioting followed in which tens of people were killed as the conditions in the country approached anarchy. A curfew was imposed to curb looting.
236. By 20 December 2001, President De la Rúa resigned. His presidency was followed by a succession of presidents over the next days, until Mr. Eduardo Duhalde took office on 1 January 2002, charged with the mandate to bring the country back to normal conditions.
237. All of these devastating conditions –economic, political, social– in the aggregate triggered the protections afforded under Article XI of the Treaty to maintain order and control the civil unrest.
238. The Tribunal rejects the notion that Article XI is only applicable in circumstances amounting to military action and war. Certainly, the conditions in Argentina in December 2001 called for immediate, decisive action to restore civil order and stop the economic decline. To conclude that such a severe economic crisis could not constitute an essential security interest is to diminish the havoc that the economy can wreak on the lives of an entire population and the ability of the Government to lead. When a State’s economic foundation is under siege, the severity of the problem can equal that of any military invasion.
239. Claimants contend that the necessity defense should not be applied here because the measures implemented by Argentina were not the only means available to respond to the crisis. The Tribunal rejects this assertion. Article XI refers to situations in which a State has no choice but to act. A State may

have several responses at its disposal to maintain public order or protect its essential security interests. In this sense, it is recognized that Argentina's suspension of the calculation of tariffs in U.S. dollars and the PPI adjustment of tariffs was a legitimate way of protecting its social and economic system.

240. The Tribunal has determined that Argentina's enactment of the Emergency Law was a necessary and legitimate measure on the part of the Argentine Government. Under the conditions the Government faced in December 2001, time was of the essence in crafting a response. Drafted in just six days, the Emergency Law took the swift, unilateral action against the economic crisis that was necessary at the time (Hearing on the Merits, 25 January 2005, Ratti, Spanish Transcript, pp. 415-419).

241. In drafting the Emergency Law, the Government considered the interests of the foreign investors, and concluded that it "could not leave sectors of the economy operating with the brutally dollarized economy –[the] system was in crisis, so we had to cut off that process, and we had to establish a new set of rules for everybody." (Hearing on the Merits, 25 January 2005, Ratti, Spanish Transcript, p. 417). Argentina's strategy to deal with the thousands of public utility contracts that could not be individually assessed during the period of crisis was to implement "across-the-board solutions" and then renegotiate the contracts (Hearing on the Merits, 26 January 2005, Roubini, Spanish Transcript, p. 635). The Tribunal accepts the necessity of approaching enactment of a stop-gap measure in this manner and therefore rejects Claimants' objection that Argentina's unilateral response was not necessary.

242. The Tribunal accepts that the provisions of the Emergency Law that abrogated calculation of the tariffs in U.S. dollars and PPI adjustments, as well as freezing tariffs were necessary measures to deal with the extremely serious economic crisis. Indeed, it would be unreasonable to conclude that during this period the Government should have implemented a tariff increase pursuant to an index pegged to an economy experiencing a high inflationary

period (the United States). The severe devaluation of the peso against the dollar renders the Government's decision to abandon the calculation of tariffs in dollars reasonable. Similarly, the Government deemed that freezing gas tariffs altogether during the crisis period was necessary, and Claimants have not provided any reason as to why such measure would not provide immediate relief from the crisis.

243. The Tribunal will now turn to Article IV(3) of the Treaty, which provides:

“Nationals or companies of either Party whose investments suffer losses in the territory of the other Party owing to war or other armed conflict, revolution, *state of national emergency*, insurrection, civil disturbance or other similar events shall be accorded treatment by such other Party no less favorable than that accorded to its own nationals or companies or to nationals or companies of any third country, whichever is the more favorable treatment, as regards any measures it adopts in relation to such losses.” (Emphasis added)

244. Article IV(3) of the Treaty confirms that the States Party to the Bilateral Treaty contemplated the state of national emergency as a separate category of exceptional circumstances. That is in line with the Tribunal's interpretation of Article XI of the Treaty. Furthermore, the Tribunal has determined, as a factual matter that the grave crisis in Argentina lasted from 1 December 2001 until 26 April 2003. It has not been shown convincingly to the Tribunal that during that period the provisions of Article IV(3) of the Treaty have been violated by Argentina. On the contrary, during that period, the measures taken by Argentina were “across the board.”

245. In the previous analysis, the Tribunal has determined that the conditions in Argentina from 1 December 2001 until 26 April 2003 were such that Argentina is excused from liability for the alleged violation of its Treaty obligations due to the responsive measures it enacted. The concept of excusing a State for the responsibility for violation of its international obligations during what is called a “state of necessity” or “state of emergency” also exists in international law. While the Tribunal considers

that the protections afforded by Article XI have been triggered in this case, and are sufficient to excuse Argentina's liability, the Tribunal recognizes that satisfaction of the state of necessity standard as it exists in international law (reflected in Article 25 of the ILC's Draft Articles on State Responsibility) supports the Tribunal's conclusion.<sup>62</sup>

246. In international law, a state of necessity is marked by certain characteristics that must be present in order for a State to invoke this defense. As articulated by Roberto Ago, one of the mentors of the Draft Articles on State Responsibility, a state of necessity is identified by those conditions in which a State is threatened by a serious danger to its existence, to its political or economic survival, to the possibility of maintaining its essential services in operation, to the preservation of its internal peace, or to the survival of part of its territory.<sup>63</sup> In other words, the State must be dealing with interests that are essential or particularly important.<sup>64</sup>

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<sup>62</sup>Article 25 of the Draft Articles on Responsibility of States for Internationally Wrongful Acts provides:

1. "Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act:
  - a) Is the only way for the State to safeguard an essential interest against a grave and imminent peril; and
  - b) Does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole.
2. In any case, necessity may not be invoked by a State as a ground for precluding wrongfulness if:
  - a) The international obligation in question excludes the possibility of invoking necessity; or
  - b) The State has contributed to the situation of necessity."

The ILC's Draft Articles, after some debate regarding the original prepared under the auspices of the Society of Nations in 1930, was abandoned and then resumed by the General Assembly in 1963. Its definitive version, due mainly to the works of Mssrs. Roberto Ago, Willem Riphagen and Gaetano Arangio-Ruiz, was approved in 1981 and subject to a revision in 1998, which was approved in 2001, during the 85<sup>th</sup> plenary session of the United Nations' General Assembly. (Session dated 12 December 2001, during the fifty-sixth session, Agenda item 162 of the Program, A/RES/56/83).

<sup>63</sup> United Nations, Report A/CN.4/318/ADD.5, p. 3.

<sup>64</sup> Strupp. K., *Les règles générales du Droit de la paix*, RECUEIL DES COURS, 1934 I, T. 47, pp. 259-595, especially p. 568. Similarly, the ILC has defined the state of necessity as that situation where the only means of safeguarding an essential interest of the State against a grave and imminent peril is an act that is not in conformity with an international obligation binding that State with another State. In shaping the concept of state of necessity, one must make a compulsory reference to the Russian seal furs case. There, the Russian government banned the hunting of seals near the Russian shorelines,

247. The United Nations Organization has understood that the invocation of a state of necessity depends on the concurrent existence of three circumstances, namely: a danger to the survival of the State, and not for its interests, is necessary; that danger must not have been created by the acting State; finally, the danger should be serious and imminent, so that there are no other means of avoiding it.
248. The concept of state of necessity and the requirements for its admissibility lead to the idea of prevention: the State covers itself against the risk of suffering certain damages. Hence, the possibility of alleging the state of necessity is closely bound by the requirement that there should be a serious and imminent threat and no means to avoid it. Such circumstances, in principle, have been left to the State's subjective appreciation, a conclusion accepted by the International Law Commission. Nevertheless, the Commission was well aware of the fact that this exception, requiring admissibility, has been frequently abused by States, thus opening up a very easy opportunity to violate the international law with impunity. The Commission has set in its Draft Articles on State Responsibility very restrictive conditions to account for its admissibility, reducing such subjectivity.<sup>65</sup>
249. James Crawford, who was rapporteur of the Draft Articles approved in 2001, noted that when a State invokes the state of necessity, it has full knowledge of the fact that it deliberately chooses a procedure that does not abide an

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including international waters and founded such decision on the absolute need to adopt immediate provisional measures. In a communication addressed, on the occasion of this incident, by the Russian foreign Minister, Chickline, to the British Ambassador, Morier, the main elements of the state of necessity were established: the absolutely exceptional nature of the alleged situation; the imminent character of the threat against an important State interest; the impossibility of avoiding the risk with other means, and the necessarily temporary nature of this justification, linked to the due danger's persistence. *See* United Nations, Report of the International Law Commission on the work performed during its 32<sup>nd</sup> session, p. 87.

<sup>65</sup> United Nations, Report A/CN.4/315, p. 78.

international obligation.<sup>66</sup> This deliberate action on the part of the State is therefore subject to the requirements of Article 25 of the Draft Articles, which must concur jointly and without which it is not possible to exclude under international law the wrongfulness of a State's act that violates an international obligation.

250. Taking each element in turn, Article 25 requires first that the act must be the only means available to the State in order to protect an interest. According to S.P. Jagota, a member of the Commission, such requirement implies that it has not been possible for the State to “avoid by any other means, even a much more onerous one that could have been adopted and maintained the respect of international obligations. The State must have exhausted all possible legal means before being forced to act as it does.”<sup>67</sup> Any act that goes beyond the limits of what is strictly necessary “may not be considered as no longer being, as such, a wrongful act, even if justification of the necessity may have been admitted.”<sup>68</sup>

251. The interest subject to protection also must be essential for the State. What qualifies as an “essential” interest is not limited to those interests referring to the State's existence. As evidence demonstrates, economic, financial or those interests related to the protection of the State against any danger seriously compromising its internal or external situation, are also considered essential interests. Roberto Ago has stated that essential interests include those related to “different matters such as the economy, ecology or other.”<sup>69</sup> Julio Barboza affirmed that the threat to an essential interest would be identified by considering, among other things, “a serious threat against the existence of the State, against its political or economic survival, against the

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<sup>66</sup> Crawford, James, *Second Report on State Responsibility*, UN General Assembly, International Law Commission, 51<sup>st</sup> Session, Geneva, 23 July 1999, A/CN.4/498/Add 2, p. 27-28.

<sup>67</sup> United Nations, Report A/CN.4/SER.A/1980, pp. 155 and 175.

<sup>68</sup> *Ibidem*.

<sup>69</sup> United Nations, Report A/CN.4/SER.A/1980, p.174.

maintenance of its essential services and operational possibilities, or against the conservation of internal peace or its territory's ecology.”<sup>70</sup>

252. James Crawford has stated that no opinion may be offered *a priori* of “essential interest,” but one should understand that it is not the case of the State’s “existence”, since the “purpose of the positive law of self-defense is to safeguard that existence.”<sup>71</sup> Thus, an interest’s greater or lesser essential, must be determined as a function of the set of conditions in which the State finds itself under specific situations. The requirement is to appreciate the conditions of each specific case where an interest is in play, since what is essential cannot be predetermined in the abstract.<sup>72</sup>

253. The interest must be threatened by a serious and imminent danger. The threat, according to Roberto Ago, “must be ‘extremely grave’ and ‘imminent.’”<sup>73</sup> In this respect, James Crawford has opined that the danger must be established objectively and not only deemed possible.<sup>74</sup> It must be imminent in the sense that it will soon occur.

254. The action taken by the State may not seriously impair another State’s interest. In this respect, the Commission has observed that the interest sacrificed for the sake of necessity must be, evidently, less important than the interest sought to be preserved through the action.<sup>75</sup> The idea is to prevent against the possibility of invoking the state of necessity only for the safeguard of a non-essential interest.

255. The international obligation at issue must allow invocation of the state of

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<sup>70</sup> *Ibidem.*

<sup>71</sup> Crawford, James, *Second Report on State Responsibility, op. cit.*, p. 30.

<sup>72</sup> *Ibidem.*

<sup>73</sup> United Nations, Report A/CN.4/318/ADD.5-7. p. 20.

<sup>74</sup> Crawford, James, *Second Report on State Responsibility op. cit.*, p. 31. In fact, this is so reflected in Principle 15 of the Rio Declaration on Environment and Development, adopted by the United Nations’ Conference on Environment and Development in 1992.

<sup>75</sup> United Nations, Report A/CN.4/318/ADD.5-7. p. 20.



necessity. The inclusion of an article authorizing the state of necessity in a Bilateral Investment Treaty constitutes the acceptance, in the relations between States, of the possibility that one of them may invoke the state of necessity.

256. The State must not have contributed to the production of the state of necessity. It seems logical that if the State has contributed to cause the emergency, it should be prevented from invoking the state of necessity. If there is fault by the State, the exception disappears, since in such case the causal relationship between the State's act and the damage caused is produced. The Tribunal considers that, in the first place, Claimants have not proved that Argentina has contributed to cause the severe crisis faced by the country; secondly, the attitude adopted by the Argentine Government has shown a desire to slow down by all the means available the severity of the crisis.

257. The essential interests of the Argentine State were threatened in December 2001. It faced an extremely serious threat to its existence, its political and economic survival, to the possibility of maintaining its essential services in operation, and to the preservation of its internal peace. There is no serious evidence in the record that Argentina contributed to the crisis resulting in the state of necessity. In this circumstances, an economic recovery package was the only means to respond to the crisis. Although there may have been a number of ways to draft the economic recovery plan, the evidence before the Tribunal demonstrates that an across-the-board response was necessary, and the tariffs on public utilities had to be addressed. It cannot be said that any other State's rights were seriously impaired by the measures taken by Argentina during the crisis. Finally, as addressed above, Article XI of the Treaty exempts Argentina of responsibility for measures enacted during the state of necessity.

258. While this analysis concerning Article 25 of the Draft Articles on State Responsibility alone does not establish Argentina's defense, it supports the

Tribunal's analysis with regard to the meaning of Article XI's requirement that the measures implemented by Argentina had to have been necessary either for the maintenance of public order or the protection of its own essential security interests.

259. Having found that the requirements for invoking the state of necessity were satisfied, the Tribunal considers that it is the factor excluding the State from its liability vis-à-vis the damage caused as a result of the measures adopted by Argentina in response to the severe crisis suffered by the country.
260. With regard to Article 27 of the United Nations' Draft Articles alleged by Claimants, the Tribunal opines that the article at issue does not specifically refer to the compensation for one or all the losses incurred by an investor as a result of the measures adopted by a State during a state of necessity. The commentary introduced by the Special Rapporteur establishes that Article 27 "*does not attempt to specify in what circumstances compensation would be payable*".<sup>76</sup> The rule does not specify if compensation is payable during the state of necessity or whether the State should reassume its obligations. In this case, this Tribunal's interpretation of Article XI of the Treaty provides the answer.
261. Following this interpretation the Tribunal considers that Article XI establishes the state of necessity as a ground for exclusion from wrongfulness of an act of the State, and therefore, the State is exempted from liability. This exception is appropriate only in emergency situations; and once the situation has been overcome, i.e. certain degree of stability has been recovered; the State is no longer exempted from responsibility for any violation of its obligations under the international law and shall reassume them immediately.

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<sup>76</sup>Crawford, James, *The International Law Commission's Articles on State Responsibility*, Cambridge University Press, 2002, p. 178 *et seq.*

**(iv) Consequences of the State of Necessity**

262. Three relevant issues arise with respect to the Tribunal's finding Argentina is entitled to invoke the state of necessity as contemplated by Article XI, and general international law.
263. The first issue deals with the determination of the period during which the state of necessity occurred. As previously indicated, in the view of the Tribunal, the state of necessity in this case began on 1 December 2001 and ended on 26 April 2003, when President Kirchner was elected (*see* the Tribunal's Analysis). All measures adopted by Argentina in breach of the Treaty before<sup>77</sup> and after the period during which the state of necessity prevailed, shall have all their effects and shall be taken into account by the Tribunal to estimate the damages.
264. The second issue related to the effects of the state of necessity is to determine the subject upon which the consequences of the measures adopted by the host State during the state of necessity shall fall. As established in the Tribunal's Analysis, Article 27 of ILC's Draft Articles, as well as Article XI of the Treaty, does not specify if any compensation is payable to the party affected by losses during the state of necessity. Nevertheless, and in accordance with that expressed under paragraphs 260 and 261 *supra*, this Tribunal has decided that the damages suffered during the state of necessity should be borne by the investor.
265. The third issue is related to what Argentina should have done, once the state of necessity was over on 26 April 2003. The very following day (27 April), Argentina's obligations were once again effective. Therefore, Respondent should have reestablished the tariff scheme offered to LG&E or, at least, it should have compensated Claimants for the losses incurred on account of the

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<sup>77</sup> The period before the state of necessity initiates with the injunction issued by the Argentine Court on 18 August 2000.

measures adopted before and after the state of necessity.

(v) **Conclusions of the Tribunal**

266. Based on the analysis of the state of necessity, the Tribunal concludes that, first, said state started on 1 December 2001 and ended on 26 April 2003; second, during that period Argentina is exempt of responsibility, and accordingly, the Claimants should bear the consequences of the measures taken by the host State; and finally, the Respondent should have restored the tariff regime on 27 April 2003, or should have compensated the Claimants, which did not occur. As a result, Argentina is liable as from that date to Claimants for damages.

**VII. DECISION OF THE TRIBUNAL ON LIABILITY**

267. For the foregoing reasons, the Tribunal renders its decision, partially granting LG&E's claims, as follows:
- a. The claim for expropriation of the investment is hereby dismissed.
  - b. Argentina breached the standard of fair and equitable treatment, no less favorable treatment than that to be accorded under the international law, and adopted discriminatory measures, causing damage to LG&E. Argentina's abrogation of the guarantees under the statutory framework, as indicated under paragraph 175 *supra*, violated its obligations to Claimants' investments, giving rise to liability under the umbrella clause.
  - c. The standard prohibiting the adoption of arbitrary measures is not deemed to have been violated.
  - d. Between 1 December 2001 and 26 April 2003, Argentina was in a state of necessity, for which reason it shall be exempted from the payment of compensation for damages incurred during that period.

- e. The Argentine Republic is liable for damages to Claimants for the aforementioned violations, except during the period of the state of necessity, which damages, including interest, as well as specification of the periods during which Respondent has incurred in violation of its international obligations, shall be determined in a next phase of the arbitration and in respect of which the Tribunal retains jurisdiction.
- f. Any decision on the costs of the arbitration is reserved.

Made in Washington, D.C., in English and Spanish, both versions equally authentic.

*(signed)*

Professor Albert Jan van den Berg

Arbitrator

Date: 19 September 2006

*(signed)*

Judge Francisco Rezek

Arbitrator

Date: 21 September 2006

*(signed)*

Dr. Tatiana B. de Maekelt

President

Date: 26 September 2006