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Inside this month's issue:

UPCOMING EVENTS

- *28 May 2010: Conference on 'The UNCITRAL Model Law on International Commercial Arbitration: 25 years' organized by the Association for International Arbitration in Brussels, Belgium.*
- ***22 October 2010**: Conference on 'The Most-Favored-Nation Treatment of Substantive Rights' organized by the Association for International Arbitration in Brussels, Belgium.*

For further information, please visit our website at http://www.arbitration-adr.org/activities/?p=conference&a=upcoming

THE 'TRUE MEANING' OF FAIR AND EQUITABLE TREATMENT?

Foreign investment is always seen as a crucial element for the growth of any national economy. To help proliferate this various standard protections are offered to investors in Bilateral Investment Treaties ('BIT') and Multilateral Investment Treaties ('MIT'). One which is virtually always present is fair and equitable treatment ('FET'). On a very brief examination, it is apparent that this protection has never received a clear and concise definition. As the 2009 study conducted by United Nations Conference on Trade and Development ('UNCTAD') reveals, this is the most commonly invoked protection and also is the most successful basis for treaty claims. It is often attested as being the rule of investment treaties which has the ability to affect the internal rulings of a state the most. Thus it demands more detailed analysis to combat the lack of fundamental conceptual understanding.

Much confusion arises from the different definitions of FET found in various investment agreements and treaties. Agreements can be found where FET is defined without any reference to customary International Law or any other criteria to determine the standard of protection to be provided. One such example is found in the UK Model BIT (2005). This leaves room for very broad interpretation of the standard to be applied and invites much uncertainty. Another category of agreements is demonstrated by the Bangladesh-Islamic Republic of Iran BIT (2001) where FET is defined relatively narrowly. Here FET for investors must be at least equal to that accorded to investors under the Most-Favored-Nation clauses or to national investors. In investment treaties such as the France-Mexico BIT (1998), the standard for FET is defined with reference to principles of International Law. It states:

"Either Contracting Party shall extend and ensure fair and equitable treatment in accordance with the principles of International Law to investments made by investors of the other Contracting Party in its territory or in its maritime area, and ensure that the exercise of the right thus recognized shall not be hindered by law or in practice."

A noticeably restrictive definition of FET is found in BITs of the category exemplified by the

France-Uganda BIT (2002). Here, it is stated:

"Either Contracting Party shall extend fair and equitable treatment in accordance with the principles of International Law to investments made by nationals and companies of the other Contracting Party on its territory or in its maritime area, and shall ensure that the exercise of the right thus recognized shall not be hindered by law or in practice. In particular, though not exclusively, shall be considered as *de jure* or *de facto* impediments to fair and equitable treatment any restriction to free movement, purchase and sale of goods and services, as well as any other measures that have a similar effect."

The language used here not only sets a standard for measuring FET but goes on further to define the actions that would be considered as being hindrances to practicing FET. The latter part listing the restrictions is cause for some concern. The words 'as well as any other measures that have a similar effect' make the definition of the restrictions relatively broad. Moreover, the wording obliges the competent tribunal to hold the specified acts as being contrary to the agreement without first evaluating if a specific act in question is truly in breach of fair and equitable treatment.

The Caribbean Common Market-Cuba BIT (1997) represents a category where reference is made only to national laws for establishing the standard of FET which is to be provided.

As a result of interpretations of FET by NAFTA tribunals, the most precise definition of FET is found in some of the most recent investment treaties where express definitions are provided. For example, the USA-Uruguay BIT (2005) provides:

'Article 5:

Minimum Standard of Treatment

1. Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.
2. For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights. The obligation in paragraph 1 to provide:
   (a) "fair and equitable treatment" includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and
   (b) "full protection and security" requires each Party to provide the level of police protection required under customary international law.'

In categorizing acts as falling foul of FET, one notices a difference even in the approaches adopted by tribunals. Certain tribunals, as exemplified by *Mondev International Ltd. v. The United States of America* (2002), carry out in-depth analysis of the facts and proceed to categorize them as violating (or not violating) FET rules without having a detailed discussion about what constitutes FET. This results in judgments where the legal reasoning behind the decisions is left unclear. Other tribunals, such as *S.D. Myers, Inc. v. Government of Canada* (2000), have approached the matter by first establishing a conceptual standard for FET to be measured by and then placing the facts of the case within this standard. The drawback of this approach is that the tribunals do not properly justify how these standards fit into the concept of FET. Many tribunals like to take a different approach by following precedent in identifying if an act is in breach of the FET protection. This is not recommendable because previous jurisprudence in this area is under attack due to a lack of understanding of the normative content of FET. Any future tribunals following these 'flawed' decisions will be defective themselves for relying on such judgments. Further, the doctrine of *stare decisis* does not exist in general international law including investment arbitration.

This lack of a prescriptive description of what constitutes a violation of FET can lead to alarming conclusions such as, decisions being made based on arbitrator's personal understanding of FET that in turn can retrospectively make a host state's measures illegal.

Perhaps an exploration of what constitutes international minimum standard could help clarify the matter slightly. In its early days, it was said in *Neer v. Mexico* (1926) that "the treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency." Whilst there is authority which recognizes this as being the definition for what constitutes the customary international law standard (*Glamis v. U.S.A.* (2009)), there is also conflicting authority rejecting the definition found in *Neer* based on the claim that the content of international minimum standard has changed since the 1920s when *Neer* was decided (*Mondev v. U.S.* (2002)). Alternatively, it has been suggested that FET should be interpreted with reference to its plain meaning. But, as found in the case of *MTD* (2004) this only leads to further broad synonyms such as 'just' and 'unbiased' thus offering only minimal guidance to the tribunals. The meaning given would depend on the interpretation of FET as found in the specific investment agreement. Thus, we still find ourselves immersed in the muddy waters of FET.

Under the umbrella of this vague term of FET, various components have been identified. They are (1) the need for predictability and consistency of the legal system, (2) legality, (3) protection of legitimate expectation of investors, (4) affording justice and due process, (5) protection against discrimination and arbitrariness, (6) maintaining transparency, (7) the requirement to be reasonable and proportional.

A detailed examination of all seven components is beyond the scope of this paper. However, although briefly, a few important points can be highlighted. In the recent case of *EDF v Romania* (2009), legitimate expectation of the investor i.e. reasonable reliance on representations made by the host state, was highlighted as one of the most important factors. However, the tribunal stated that this cannot be used in lieu of a stabilization clause to limit a State's sovereign legislative power. The expectation must be judged as being legitimate or otherwise with reference to the time when the investment was made. However, tribunals have, time and again, recognized the need for predictability and consistency of the legal framework applicable to foreign investors as noted in *OEPC v. Ecuador* (2004). FET could be violated even by domestic agencies due to inconsistent application of domestic legislation. In the same way, a lack of legality with regards to domestic law can amount to a violation of FET, for example, in *Pope & Talbot v. Canada* (2001) where the tribunal relied on a lack of the local authority's jurisdiction in initiating administrative proceedings. However, factors such as reasonableness and proportionality are not absolute in that they only serve to limit the extent to which the state could interfere with any foreign investment but a balance between the interest of the foreign investor and the host state is ensured due to the proportionality requirement.

As the law currently stands, a violation or otherwise of FET can only be judged most precisely by considering its individual components. Nevertheless, it is widely agreed that the matter needs much more in-depth analysis before it becomes a 'clear' concept of investment arbitration.

EUROPE CEMENT vs. TURKEY: WILL FRAUD 'COST' YOU?

Some essential facts

On 7th August 2009 an ICSID arbitral tribunal in the Paris offices of the World Bank possibly created a dangerous precedent in its final award in *Europe Cement Investment & Trade S.A. v. the Republic of Turkey* (ICSID Case No. ARB (AF)/07/2) by severely penalizing the claimant's alleged abuse of process. Europe Cement, a company incorporated under the laws of Poland, initially filed a claim concerning the unlawful termination by Turkey of several concession agreements the Turkish Ministry of Energy concluded with CEAS and KEPEZ, alleged affiliate companies of Europe Cement, relating to the generation, transmission, distribution and marketing of electricity in certain parts of Turkey. In fact, Europe Cement purported that the contract termination of the contract by Turkey was an illegitimate expropriation of property contrary to Article 13 of the Energy Charter Treaty. Additionally, Europe Cement complained that Turkey had failed to accord Europe Cement's investment 'fair and equitable treatment', contrary to

Article 10(1) of the Energy Charter Treaty.

Suspicion on authenticity

Turkey, however, questioned Europe Cement's trustworthiness and requested proof of Europe Cement's investments in the two Turkish companies CEAS and KEPEZ. The Tribunal partially refused this preliminary procedural request since Europe Cement was already supposed to produce those evidenciary documents when filing its Memorial of Claims. After producing copies of share certificates and share purchase agreements, Turkey's suspicion remained unchanged as it found the delivered documents inadequate for the Tribunal's judgment on the matter of the share ownership. Consequently, it challenged the authenticity of the produced evidence and demanded the originals of the share certificates or company records relating to those shares to be made available for forensic analysis.

The arbitration suffered delays due to Europe Cement's successful dilatory requests for extension of its Memorial and Production of Documents' deadline and demand to discontinue the case. As a result, Turkey was delayed by more than 7 months and decided to act on the matter instead of waiting any longer. It asked for the dismissal of Europe Cement's claims based on the arbitral tribunal's lack of jurisdiction. This, it was contended, was caused by the failure of Europe Cement to prove any reasonable interest after unlawfully upholding alleged ownership of investments in the aforementioned Turkish companies. Simultaneously, it requested adverse inferences to be drawn upon Europe Cement that the provided copies were fabricated and the claims fraudulent, justifying the full reimbursement of Turkey's legal and arbitration expenditures.

Jurisdiction à la carte?

In its final reasoning, the tribunal refused Europe Cement's request to dismiss the claim on the basis of a lack of jurisdiction since this could only occur if both parties agree upon the discontinuance. On this particular point, Turkey contested the discontinuance since it would otherwise not have been entitled to any compensation under the applicable arbitration rules. The tribunal considered the parties' disagreement somewhat ingenious. It stated that Europe Cement had only submitted to discontinue its argument so that it would be able to produce proof of the fact that it has a shareholding in CEAS and KEPEZ at the present time, not to prove its ownership over the disputed shares at the time of termination of the concession agreements. The tribunal therefore interpreted Turkey's disagreement as being only related to the discontinuance of Europe Cement's latter argument, which justified the tribunal's refusal to dismiss the claim on the basis of a lack of jurisdiction.

A bit further in the award, however, the tribunal nevertheless found itself not competent because Europe Cement could not prove its alleged share ownership at any jurisdictionally relevant time.

In other words: abuse of process…

In answer to Turkey's claim of a declaration stating that "the claim is manifestly ill-founded and has been asserted using inauthentic documents", the tribunal hinted towards abuse of process by stating that: "there was no transfer of shares in CEAS and KEPEZ to Europe Cement in May 2003 and that the Respondent is correct in its assertion that not only did the Claimant fail to prove that it had purchased the shares but that it never purchased the shares in fact. This carries with it the clear implication that the claim to share ownership was based on inauthentic documents and that the claim was fraudulent".

However, in attributing an abuse of process to Europe Cement, it made, what could be translated as, an overeager analogy with the *Phoenix Action Ltd v. Czech Republic* (ICSID Case No. ARB/06/5)-Award of 15 April 2009. In that case, the claims from Phoenix were found abusive since it made investments in Czech companies for the sole purpose of constituting a jurisdictional basis to bring international litigation against the Czech Republic. Europe Cement, however, did not purchase the disputed shares in CEAS and KEPEZ merely to arbitrate against Turkey. It simply could/would not prove its purported share ownership. The question to be answered is whether or not the lack of evidence and Europe Cement's reluctance to produce it, constitutes abuse, not whether its act of purchasing the disputed shares were made with an abusive predetermination.

Moral damages vs. legal costs

The tribunal resolved the issue by stating that "since the Claimant either had no original documents to produce or no intention of producing original documents because they would not withstand forensic examination, the continual requests for extensions of time for over a five month period could only be seen as a cynical attempt to postpone the inevitable, further contributing to the abuse of process." No compensation for moral damage was granted directly, but the tribunal believed the punishment of Europe Cement would be adequately attributed through the reimbursement of Turkey's legal costs, $3.9 million to be precise. By solely focusing its *ratio decidendi* on Europe Cement's abuse of process and Turkey's hazards to defend this claim, instead of the actual costs and expenses suffered by Turkey, however, the tribunal did implicitly punish Europe Cement cunningly using the veil of legal costs to issue an award on moral damages.

INVESTMENT ARBITRATION IN LATIN AMERICA: THE CHALLENGES

Background: The Calvo Doctrine

In the past, Latin American countries saw foreign investment as an instrument of political and economic intervention by the rich countries from the north. In this context, there was an unfriendly approach to agreements and laws facilitating access to the local markets and resources. This stance was rooted in the Calvo Doctrine promulgated by an Argentine scholar in the year 1868. The Calvo Doctrine took legal form under three ideas: i) jurisdiction over investment disputes is reserved exclusively to domestic courts where the investment is located; ii) foreign investors are entitled to the same rights as nationals investors; and iii) foreign investor are precluded from seeking any kind of diplomatic protection.

In short, foreign investment was regulated by the domestic law of the host State and disputes linked to investments could only be resolved by the State's domestic courts.

The Shifting Point: The Washington Consensus

The 1980's were for most of the Latin American countries a very difficult period in history where financial distress, high inflation rates and crises appeared to menace the economic and political stability of the region. In the midst of these circumstances, there was a new economic plan for the region which has been called the 'Washington Consensus'. The plan, which was backed by the IMF and World Bank, stressed the importance of liberalization of trade, deregulation of markets and the privatization of public enterprises, among other things.

As a consequence, Latin America experienced a tide of liberalization, deregulation and privatization since the 90's. In the context of foreign investment, governments sought to provide potential investors with internationally binding legal alternatives to domestic courts and a new set of rules, as a way to provide some sort of guarantees at the time of the investment. The principal instrument was the signing of Bilateral Investment Treaties ('BITs'). This new trend gave way to hundreds of BITs which are now in force for Latin American States. Ironically, if we consider the origin of the Calvo Doctrine, the Latin American State with most signed BITs is Argentina with a total number of fifty eight.

Additionally, it is important to have in mind that parallelly international arbitration became accepted in the region as a natural instrument for trade and business. Many Latin American States introduced changes in their domestic laws regarding arbitration with the idea of recognizing the application of foreign laws and jurisdiction over disputes with international components. In this matter, the UNCITRAL model law has been a key document in the implementation of legal reforms. Also, all Latin American States are part of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 ('the New York Convention'). Finally, most Latin American States have signed the International Convention on the Settlement of International Disputes between States and National of Other States ('the ICSID Convention'), with the important exception of Brazil and Mexico.

The Importance of Latin America in Investment Arbitration: Some Numbers

In Latin America and the Caribbean, there are 485 International Investment Agreements in effect as of June 2009. The leading countries are Argentina, Chile, Peru, Mexico, Uruguay and Ecuador with the highest number of agreements in force.

The majority of cases against States regarding investment arbitration have had a Latin American country as defendant. As a matter of fact, out of the 318 investment arbitration cases that have been filed, Latin American States had been defendants in 113. Furthermore, out of the 124 pending cases, 69 cases have been filed against Latin American countries, meaning that around 55% of the pending cases have a Latin American State involved.

Now, the Latin American countries with more cases (concluded and pending) are Argentina (46), Mexico (18), Ecuador (9) and Venezuela (7). The amount asked in the 27 concluded cases by 2008 was US$ 6,328,512,225 and the money given in total in those cases was US$ 1,031,571,826. The amount at stake in the pending cases at ICSID is about US$ 11,414,096,045. In any event, it is noteworthy that the total number of investment arbitration disputes is impossible to ascertain given the fact that ICSID is the only international institution with public registry of claims regarding this kind of proceedings.

Reactions from the Investment Arbitration Experience: The Argentinean Case and its Consequences

The case of Argentina is unique. In fact, most of the filed cases against Argentina involved disputes that are linked to the financial crisis that the country faced between the years 2001-2002 and the economic measures the Argentinean State had to take to tackle these special circumstances. While other Latin American countries have faced other problems in the last 10 years, they have not been as severe as the crisis in Argentina and these countries have experienced a positive decade in economic terms inclusive of the present financial crisis. However, the Argentinean case has been seen as a warning about what could happen as consequence of international investment law. Also, Latin American countries are now aware about the legal and economic implications involved in signing investment treaties. Without any doubt, this harsh reality faced by the Argentineans has affected the mood in the region.

The feeling about investment arbitration for some of the Latin American countries is that the rights of foreign investors exceed those enjoyed by domestic investors. Also, they think that policy makers could expose the country (and its tax payers) to potentially large-scale liabilities, plus are limiting the possibilities to implement different reform options in cases of difficulties. Finally, they consider that BITs, while providing in theory for reciprocal rights of the countries involved, are in reality in one direction (for the protection of some OECD countries).

In the case of Brazil and Mexico it is possible to foresee that they will not become part of the ICSID convention in the near future and they do not seem keen any more to sign or ratify (Brazil has not ratified any of the 14 bilateral agreements that it subscribed since the year 1994) any new BITs. Additionally, some countries have been withdrawing from ICSID (Bolivia and Ecuador), limiting the type of disputes to be submitted to ICSID (not longer submit to ICSID matters involving petroleum, gas and mining industries) or renegotiating BITs (Ecuador and Venezuela), denouncing BITs or interpreting restrictively its investment laws (Venezuela) and submitting awards for enforcement to its local courts alleging constitutional grounds (Argentina).

In contrast, other countries have followed a different path in the case of trade and investment agreements. This is the situation for countries like Chile, Colombia, Peru, Uruguay, Panama and Costa Rica which in recent years have signed or ratified some new treaties. This group of countries seems to have a more favorable approach towards the system at the moment and seem to be in a different episode if we consider the approach of the countries that have taken steps to extract themselves in whole or in part from the legal framework that provides for international investment arbitration.

Having said this, it is clear that there is still a long road ahead. It is not possible to determine in advance a unique answer about the way in which things are going to turn out in the region and the purpose of this report is not to discuss political views and positions. In any event, there is an

important concern about how arbitral decisions are addressing public interest. It seems that if decisions are strictly focused on the contractual or treaty terms relating to the parties without considering important political, economic and social consequences that follow those decisions, there is a possibility that some States could continue without participating, withdrawing or limiting the scope of investment disputes in the international arena.
At this point, it would be important to consider some of the legal, economic and political challenges that the system of investment arbitration is facing in Latin America in order to understand what the future could bring to the region in this regard.

Legal Challenges

1. Investment arbitration goes beyond international private law and the terms incorporated in contractual relations. Disputes in this field bring together two different interests: i) the duties, obligations and responsibilities of a State to its citizens and ii) the obligations and responsibilities to investors. Latin American cases provide the ideal grounds to test if it is possible to find a balance between these two interests.

2. How to articulate the principles of most favored nation ('MFN') treatment and fair and equitable treatment as well as the application of investment in a complex set of international and regional conventions and bilateral treaties.

3. The legal effects regarding the withdrawal of one party from the ICSID Convention. This is the case for Bolivia which is the first of 145 parties to withdraw from this mechanism for international dispute resolution. The same applies to Ecuador which made the same decision in last July.

Economic Challenges

1. There is a very interesting debate about the impact of international investment law in foreign direct investment. For instance, in Latin America the largest recipient of foreign direct investment is Brazil, with 28%. However, Brazil has kept a different trend concerning BITs compares to other countries in the region. In this sense, signing BITs and agreeing to international investment arbitration is not a guarantee that foreign investors will go to a specific country.

2. The region has been growing in economic terms during the last 10 years and the financial crises had a moderate effect on most of the countries. The problem is how investment agreements could affect in the future the possibility to implement economic measures during times of economic crises in developing countries.

Political Challenges

1. The perception about inequality and lack of transparency in the system by some Latin American leaders could increase the movement away from the ICSID forum and towards a different alternative. The question here is if it is possible to redress this perception.

2. There is no clear link between international investment and a positive impact in local governance, legal reforms and economic welfare. If this connection is not established this could question the legitimacy of the investment system.