A Liber Amicorum: Thomas Wälde

Law Beyond Conventional Thought

"A Liber Amicorum: Thomas Wälde - Law Beyond Conventional Thought"
Edited by Jacques Werner & Arif Hyder Ali

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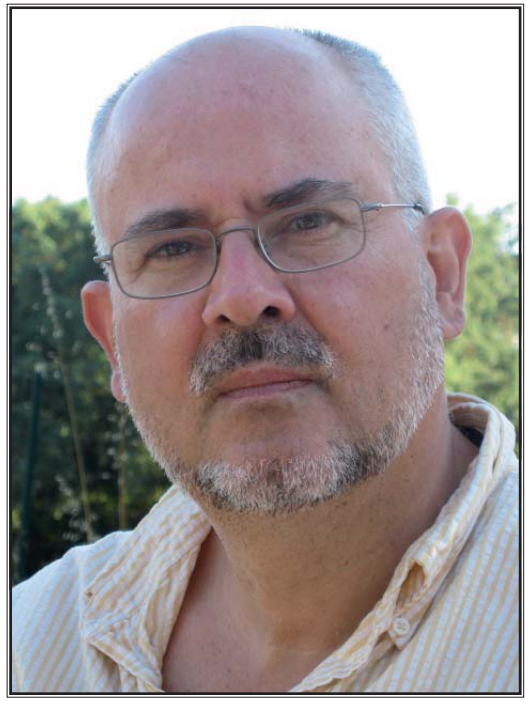

Thomas Wälde
(1949–2008)

A Liber Amicorum: Thomas Wälde

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Foreword

Thomas Wälde: professor, arbitrator, lawyer, mentor, strategist, maverick, unconventional thinker, innovator, father, husband, friend all rolled into one. This is the Thomas we knew and loved, and to him this *Liber Amicorum* is dedicated.

When Charlotte asked, we of course readily accepted the honor to serve as co-editors of this *Liber Amicorum*. And with that honor, came the need for us to find the words and sentiments to express what Thomas meant to us and to so many across the electronic world of international law, intellectual exchange, and academic thought that Thomas created and nurtured. For how does one capture in a few words all that Thomas contributed to us professionally and personally? There was – thankfully – nothing brief about Thomas, and brevity was – thankfully – never his forte.

Born in 1949, Thomas grew up in Heidelberg and went to school at the Kurfuerst-Friedrich-Gymnasium. He studied law at the Universities of Heidelberg, Lausanne-Geneva, Berlin and Frankfurt, gaining an LLM from Harvard Law School along the way.

In 1980, he joined the UN and later became UN Interregional Adviser on international investment policy and petroleum/mineral legislation. He advised over 670 governments on legislative reform and contract negotiations with international investors. He was also, from 1981 to 1983, UN investigator on occupation practices in Palestinian territories and was responsible for the Secretary General's reports on '*Permanent Sovereignty over Natural Resources*' and on the Permanent Sovereignty in Occupied Palestinian Territories. He initiated the UN project for environmental guidelines in mining and was chair of the drafting group that produced the first version of the '*Berlin Guidelines*' in 1990.

In 1991, he joined the University of Dundee as Director of the Centre for Energy, Petroleum and Mineral Law and Policy (CEPMLP). He was later awarded by the European Commission a Jean-Monnet chair in European Economic and Energy Law. Under his leadership the Centre underwent a period of spectacular growth and is now a major international institution in its field for graduate studies and research. To a great extent he developed this Centre in his own image, international and inter-disciplinary, combining academic excellence and professional

relevance. Many of its alumni hold leading positions in governments and major institutions influencing policy and practice at the highest level throughout the world. After stepping down from the post of Director in 2001, he maintained his role as a teacher and expanded his activities in the field of dispute resolution and arbitration, where he quickly enhanced his already formidable reputation.

Whilst at the University of Dundee, Thomas came up with the idea to extend his global network to develop an extraordinary virtual campus of leading practitioners and scholars around the world, who became part of the Dundee intellectual family, in many cases without every having set foot in Scotland. In recent years, OGEL became an important instrument in these networks. After a meeting in 2002 with the MARIS team, he started to work with them on OGEL and published the first issue in 2003. After an OGEL special issue on '*Dispute Management in the Oil, Gas and Energy Industries*', Thomas wanted to have an opportunity to focus on international arbitration in general as well and so he came with the idea for TDM following the same concept as OGEL. The first issue of TDM came in February 2004. Both publications have since gained popularity with international companies, governmental organizations, law firms, international agencies, academic and think-tank institutions.

There are so many of Thomas' accomplishments that could easily inform these lines, although perhaps the one that became so important to so many of us is the OGEMID on-line forum – a forum that reflected Thomas' understanding of technology and its role in intellectual development, that reflected his ability to move issues and agendas, and that connected legal and non-legal professionals from around the world in a democracy of legal dialogue, debate and thought. He urged us all to participate. No idea was too small or too mundane. And no contributor too inexperienced or ineloquent. And through this forum and all of his other activities and boundless energy and zest, he created a community and part of his legacy. He became a virtual and in-person mentor, friend and guide to the forum's many participants; and, of course, to many others as well.

Thomas urged us never to forget that humor and laughter are at the fount of intellectual liberation and the source of creative thinking. Above all, he dedicated himself to asking people to think 'outside of the box'. Take conventional wisdom, he would urge, turn it upside down, shake it, look at it from all angles and take nothing for granted. Only then will the right answer be found. In this sense, Thomas was, and will always be remembered as, the epitome of George Bernard Shaw's 'unreasonable man':

> The reasonable man adapts himself to the world; the unreasonable one persists in trying to adapt the world to himself. Therefore, all progress depends on the unreasonable man.

Evident from the preceding paragraphs about Thomas' life and career is the fact that this book is but a modest effort to capture Thomas' never ending interests. His legacy, however, is far greater and one that, in its own way, will continue to impact the world of international law for many decades to come.

The editors would like to give their sincere thanks to all the authors for their hours of labor in dedication to this Liber Amicorum, to Arthur Warden for his careful and diligent editorial assistance, to Michael Laughton for his tenacious and diplomatic management of this project, and to Jessica Ferrante for her constant and able assistance.

Jacques Werner, Geneva, September 2009
Arif Hyder Ali, Washington DC, September 2009

Search Engines, Copyright and Innovative Business Models: How Google Sought to Free/ Monopolise [Delete as Appropriate] the Printed Word

Charlotte Wälde*

I. Introduction

Lieber Thomas. What troubles I have had in thinking about the contribution I could make to this Liber Amicorum. Beyond our private lives you and I of course shared much in our working lives. On the latter, most notably, we shared professions although our areas of expertise were different. This led to much debate, often lively disagreement, and sometimes a meeting of minds on finer points of law. You were the most intellectually creative lawyer I have known. Part of this creativity drove you continually to question perceived wisdom, contemporary perspectives and accepted understandings within your fields of expertise and beyond. You revelled in exposing hypocrisy, cutting through the cosy cartel like relationships between players at all levels of business and society and in so doing explain and illustrate, in your uniquely colourful style, how the world could be better ordered, and the role that law could, and should, play in that re-ordering.

How then to continue our discussions in a subject area that would be of interest to you and suitable for inclusion in this collection? And then it came to me. You had, of course, many 'strings to your bow'. First and foremost you were an intellectual: that was your core and was given expression through your academic work and your leadership of the CEPMLP[1] of which you were justly proud. But unusually for an academic you also had practical, business-related interests that sprang out of your academic pursuits and which you developed with enormous energy, drive and enthusiasm. One was arbitration – an area that you were passionate about. Another was your publishing business OGEL[2]

* Charlotte Waelde, Professor of Intellectual Property Law, University of Edinburgh.

[1] The Centre for Energy, Petroleum and Mineral Law and Policy at the University of Dundee. http://www.dundee.ac.uk/cepmlp.

[2] Oil, Gas & Energy Law. Global Energy Law and Regulation Portal. http://www.ogel.org.

and TDM[3] linked to the discussion fora, OGELForum and OGEMID. These vehicles enabled you to bring together current thinking in the areas of oil, gas and energy law (OGEL and OGELForum) and to provide intelligence and high level discussion of commercial arbitration, investment dispute management and ADR (TDM and OGEMID). In 2008 you explained some of your thoughts on OGEMID in your very typical style. 'Professors and authorities have a very difficult time with OGEMID: it breaks up closed-shop information monopoly and you can discuss in a more (never full in life) equal level. Pomposity does not live easily on an instant electronic discussion forum'.[4]

Our link is in your reference to 'information monopoly' although we use the term to mean something different. Your use refers to the availability of information and knowledge and to the power that this can give to 'those in the know'. My use is in relation to the expression of information and the 'monopoly' power granted to the owner of that expression through the law of copyright.[5] Copyright was something of which you were well aware but which you considered needed to be carefully managed if a publishing business was to flourish. Copyright is certainly something of which Google is well aware, having been sued in many jurisdictions for one infringement or another whilst pursuing its business strategies.[6] This comment will consider the latest, and currently most high profile copyright challenge to one of Google's business models, Google Book Search, and which illustrates great efforts to reach private agreement against a background of attempted, but stalled, public regulation.

II. Google Books

Google is the biggest search engine currently in operation. 'Biggest' in this context means the largest in terms of market share; numbers of searches across and within jurisdictions; revenue; and business portfolio, amongst other measures.[7] Google has reached this poll position by innovating and risk taking. Much of what Google does involves aggregating, sorting, storing, categorising and making information

[3] Transnational Dispute Management (www.transnational-dispute-management.com).

[4] http://www.asil.org/ilpost/president/071108_1.pdf.

[5] E.g. Copyright Designs and Patents Act 1988 s 3(2). Copyright protects the expression of ideas and not ideas themselves. Agreement on Trade Related Aspects of Intellectual Property Rights 1994 (TRIPs) Article 9.2.

[6] Some examples of cases are given below. Others include *Field v Google Inc.* (US District Court District of Nevada, No. CV-S-04-0413-RCJ-LRL, 12 January 2006; *Parker . Google Inc.* (US District Court Eastern District of Pennsylvania, No. 04-CV-3918, 10 March 2006; *Perfect 10 Inc. v Google* 416 F. Supp. 2d 828 (C.D. Cal. 2006). *WBG (German publisher) v. Google.* For information see http://www.linksandlaw.com/google-print-timeline-3-book-search.htm. For a general list see www.linksandlaw.com.

[7] See for example information compiled by Hitwise available at http://weblogs.hitwise.com/robin-goad/2008/04/how_popular_is_googles_pages_from__the_uk_search_option.html.

available. Stemming from Google's best known service – the search engine[8] – Google makes tailored products available, such as news[9], financial information[10], images[11] and scholarly articles.[12]

The focus of this comment is Google Book Search (formerly Google Print).[13] In this project, Google states that its goal is to 'digitize the world's books in order to make them easier for people to find and buy'.[14] It differs from the other projects described above in that it does not aggregate information that is already available on the Internet, but rather books are manually scanned[15] and then made available through one of two programs:

> • ***Google Books Partner Program (formerly Print Publisher Programme):*** Google scans and saves the complete book. Users can see a few pages or the whole of the book depending on the permission given by the publisher.
> • ***Google Books Library Project (formerly Print Library Project):*** Google scans and saves complete book. Where the book is protected by copyright the users only see a few lines of text (commonly known as 'snippets') and not more than 3 instances per search plus a link to a site where the book can be purchased or a library where it can be borrowed. Where the term of copyright has expired, then the complete book is available for download.

To populate the database books are selected on an individual basis and then scanned into the system. Google has a crawler[16] which works on this database of information. From this, search results are returned to the user. The results can be striking. I tried a search for 'Waelde' which returned 1009 hits within .04 seconds. I then tried 'Wälde' which returned 11300 hits within .14 seconds. A good number of these related to woods and trees. So I tried 'Thomas Wälde' – and got 1880 hits within .13 seconds.[17] This was deeply impressive.

A. The Program, the Project and Copyright

The Google Books Partner Program raises no copyright issues as it is based on agreement between the publisher and Google. The Google

[8] http://www.google.co.uk and other gTLDs.
[9] http://news.google.co.uk.
[10] http://www.google.co.uk.
[11] http://images.google.co.uk.
[12] http://scholar.google.co.uk.
[13] http://books.google.co.uk.
[14] http://books.google.com.
[15] For an insight into what can happen when the scanning takes place too fast see http://www.techcrunch.com/2007/12/06/google-books-adds-hand-scans.
[16] A Crawler is a program which searches the web and copies (or Spiders) content and stores it on a server which, for Google, is known as the Google cache.
[17] I carried out the search on Monday 11 May 2009.

Books Library Project does however have implications for copyright as Google scans books and makes available the snippets without permission from the publisher who is often the owner of the copyright after taking an assignation (or exclusive licence) from the author. Google gives publishers the opportunity to opt-out of having their portfolios of books scanned either before the scanning takes place, or after the book has been scanned and made available. Before the scan is made, the publisher can give notice to Google that the work should not be included in the database. If the scan has already been made and is in the database, Google will remove this on request by the publisher. This strategy, Google argues, is legitimised by the notice and take down provisions enacted in many domestic laws.[18]

The publishers and authors, perhaps unsurprisingly, object to this business strategy. Copyright has always been about the right to exercise ex ante control over creative works; to give, or refuse, permission to others to exploit the protected work in a manner and under conditions agreed with the owner of the copyright. Google's strategy turns this on its head. In essence Google takes control over the making of the work available in digital form within the book database unless objection is intimated by the publisher. The key issue is thus one of control over content.

B. Case Law Challenges

In 2005, the Author's Guild launched an action against Google in the US.[19] This was a class action on behalf authors alleging 'massive' copyright infringement of their rights through the reproduction of their works without consent. In October 2005, in an action coordinated and funded by the Association of American Publishers, a request for injunctive relief was filed against Google alleging infringement of the exclusive rights of the publishers by way of the reproduction and distribution of their books.[20] As will be discussed below, a negotiated settlement between these parties was made public in November 2008.

In Germany, a petition by WBG (a German publisher) for a preliminary injunction against Google (Regional Court Hamburg) was withdrawn in June 2006 after the court indicated that the petition was unlikely to succeed.[21] It was said that the presentation of snippets from the books was unlikely to infringe German copyright law, and that it was unlikely that German copyright would apply to scanning/copying of the books as that activity took place in the US.

[18] In Europe the Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market. In the US the Digital Millennium Copyright Act 1998.
[19] No. 05 CV 8136 (S.D.N.Y, filed 20 Sept. 2005).
[20] *McGraw-Hill Companies, Inc. v Google*, No. 05 CV 8881 (S.D.N.Y, filed 19 Oct 2005).

In France, also in June 2006, the publishing group La Martinière sued Google France and Google Inc for infringement of their intellectual property rights. La Martinière was joined in the lawsuit in October 2006 by Syndicat national de L'Edition (SNE), an association representing 400 publishers.[22] This action is still pending.

C. The Arguments

Google argues that it is not liable for infringement of copyright. Pointing to the choices that the publisher has for opting out of the program, Google is of the view that this negates any infringement liability. Further, and in the US at least (which is where the scanning takes place), if infringement were found, Google argues that it has a defence as the scanning of the work amounts to fair use as does the presentation of snippets.[23] Unsurprisingly others, and in particular publishers and authors, do not agree with these views. As indicated above, Google's argument turns the exclusive rights granted to copyright owners on their head by saying that there is a right to reproduce a work unless the owner opts out.[24] Copyright has always been about exclusivity for the owner, not the user. On the matter of fair use and copying of the entire work, some deny that the copying of the whole of a work could ever be regarded as fair even where it enabled a use which is fair (in this case, the presentation of the snippets[25]). Also on the question of fair use, where the use impacts on the commercial interests of the right holder, US case law suggests that it is unlikely to be regarded as fair.[26] In both US actions the applicants have stressed the commercial nature of the project – Google aims to increase its advertising revenue from the program.[27]

D. Shaping Strategies within Jurisdictional Divergences

Although the issues remain unsettled, these arguments are the basis on which Google has shaped its business strategy for scanning and making books available though this program, and within which Google

[21] *WBG (German publisher) v Google*. For information see http://www.linksandlaw.com/google-print-timeline-3-book-search.htm.
[22] See the BBC news website at http://news.bbc.co.uk/1/hi/entertainment/5052912.stm.
[23] See for example the Official Google Blog. *Google Print and the Authors Guild*. 20 September 2005. http://googleblog.blogspot.com/2005/09/google-print-and-authors-guild.html.
[24] Note the Belgian court in *Copiepresse SCRL v. Google Inc*. [2007] European Copyright and Design Reports 5 did not accept the arguments.
[25] *McGraw-Hill Companies, Inc. et al. v Google Inc*., Case No. 05 CV 8881 (S.D.N.Y.).
[26] E.g *Field v Google Inc.* (US District Court District of Nevada, No. CV-S-04-0413-RCJ-LRL, 12 January 2006).
[27] On this Google says that 'We don't place ads on a specific book result unless the copyright holder has given us permission to display portions of the book and wants to show ads'. The revenue is shared between Google and the publisher. http://books.google.com/googlebooks/facts.html.

seeks shelter. The differences in the laws of various jurisdictions must mean that Google feels more comfortable in some countries than others with regard to the processes involved in the program, from scanning books to presentation of the results. The US fair use doctrine,[28] with its inherent flexibilities, does not have a counterpart in the majority of European countries (or elsewhere). In carrying out its scanning activities in particular, Google and those developing similar projects are likely to gravitate to the US where they may be shielded by the law. On the availability of content, because the law has uncertain parameters, fewer books will be searchable than might otherwise be the case. Many libraries joining the project, whether in the US or elsewhere, only agree to the scanning of material in the public domain. Beyond that, Google tends to concentrate on older books and those out of print.[29]

All this also has an impact upon cultural diversity. Because Google relies on broad fair use in the US for scanning the books and carries out that activity within the US, it is more likely that these will be in English than in other languages to the impoverishment of non-English language speakers. Perhaps sensitive to this last point, Europe has, since 2005, been working on its own Digital Libraries Initiative. The plan is to make 'Europe's diverse cultural and scientific heritage (books, films, maps, photographs, music, etc.) easier and more interesting to use online for work, leisure and/or study. It builds on Europe's rich heritage combining multicultural and multilingual environments with technological advances and new business models.' [30] While there are some notable collections already available within Europe, it would appear that the ambitious project is still grappling with copyright issues.[31]

The availability of content can vary from the perspective of the user even within Member States of the EU where many laws should be at least approximated even if not harmonised. This can be seen in the aftermath of the ruling issued against Google in the Belgian case of *Copiepresse v Google Inc*.[32] In this case the President of the Civil Court of First Instance

[28] US Copyright Act Title 17 § 106.

[29] According to Google those books should be favoured because they are more worth making searchable/visible, but one can suspect that Google wants to await the outcomes of the litigation before it spends money on the scanning of copyrighted books because Google might be required to delete/not use the copies made.

[30] http://ec.europa.eu/information_society/activities/digital_libraries/what_is_dli/index_en.htm.

[31] See for example Commission Recommendation of 18 May 2005 on collective cross-border management of copyright and related rights for legitimate online music Services (2005/737/EC); and COM(2007) 836 final Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the on Creative Content Online in the Single Market {SEC(2007) 1710}.

[32] *Copiepresse SCRL v Google Inc*. [2007] European Copyright and Design Reports 5. For general comments see B Van Asbroeck, and B Cock, 'Belgian newspapers *v* Google News', *Cont.*

in Brussels – on appeal from Google – confirmed that Google's practice of providing news clippings infringed the publishers' copyright in the original news reports.[33] The similarities with the strategy chosen by Google for the Book Program included the copying and storing of information albeit sourced from the Internet rather than separately scanned, and the presentation of snippet views. One part of the order granted against Google required the search engine to remove content in which copyright belonged to the French and German publishers from its Belgian website or pay a fine of 1 million Euros daily. As a result, Google almost immediately removed access to over ten sites within the .be domain, although the same content remained available from other Google sites such as Google.com.[34] That content would still have been accessible to users within Belgium, but perhaps not all users would have thought to search on different sites. One can imagine that an adverse decision for Google in the cases brought by La Martinière and Syndicat national de L'Edition[35] may result in the non-availability of the content in the form served by Google in France – but not elsewhere.

F. The Book Program and the Public Interest

While control may then lie in the hands of the publishers, the result, it would seem, would do little to make available these works to the consuming public.

This leads to consideration of the place of one of the public policy goals of copyright in relation to the Book Program. A key rationale upon which the law of copyright is based is that, by ascribing property rights in creative works, so authors will have the incentive to create more thus ensuring that the public has a wide variety of works and information available for consumption, and upon which future works can be built. Copyright thus gives the necessary incentive to the author to continue creating afresh. Although the Book Program does not itself result in the creation of new works, a question arises as to whether it increases accessibility of existing works. One way to show that Google Book Search does help to attain this goal might be to compare the numbers of times a work is accessed by a user on Google book search with the number of uses of a work in hard copy format (such as through book sales; library loans). However, obtaining evidence from Google that

(2007) 2:7 *Journal of Intellectual Property & Practice* 463–466; M Turner and D Callaghan, 'You Can Look But Don't Touch! The Impact of the Google *v* Copiepresse Decision On the Future of the Internet' (2008) *E.I.P.R.* 34-38.

[33] The court held that the caching and storing of the news reports constituted copying and allowing users to access these stored news reports constituted communication to the public and was not saved by the temporary copy defence in Belgian law.

[34] http://blog.searchenginewatch.com/blog/060920-152314.

[35] Supra n. 22.

might support or undermine the claim is no easy task. Information on such matters as numbers of users, what they search for, whether a 'find' through the book search is likely to result in the downstream sale of a book, are said to be 'things that Google doesn't talk about'.[36] A Google search has however revealed that Heather Hopkins of Hitwise, a company that analyses web behaviour said that 'Last week [August 2006] 15.93% of downstream visits from Google Book Search UK went to websites in the Hitwise Shopping and Classifieds – Books category.'[37] This suggests, although not as clearly as one might like, that Google Book Search might enhance downstream sales – users may be obtaining access to works they might not otherwise have known about or have been able to find.

While this would be a very different way in which this public interest goal might be met, it is at least an argument, moulded and adapted for the digital era, for why, despite the challenges posed for the law of copyright as it has existed and been justified at least in the UK since 1709,[38] the Book Search might be supported from within the existing law.

III. Google Book Settlement

But time has not stood still. As indicated above, several challenges have been mounted against Google Book Search. However, in 2008 it appeared that Google and the Authors Guild had managed to settle their differences in an agreement that has come to be known as The Google Book Settlement (the Settlement).[39] The Settlement is subject to ratification by the New York District Court in a fairness hearing which was due to have taken place on 11 June 2009. However, for reasons that will be explained below, this has been postponed until 7 October 2009.[40]

The Settlement proposes the establishment of a Book Rights Registry (the Registry). The purpose of the Registry, which is essentially a collecting society, is to maintain a database of rights holders, collect their contact details and information regarding requests with respect to uses of books,

[36] Email communication by Google, February 2008.
[37] http://twopointouch.com/2006/08/31/googles-book-statistics/.
[38] Statute of Anne 1709, the first copyright Act.
[39] Full information available at http://www.googlebooksettlement.com.
[40] If it is ratified then the publishers in *The McGraw-Hill Companies, Inc. et al. v Google Inc.*, Case No. 05 CV 8881 (S.D.N.Y.) will dismiss their separate suit against Google. Given that the case has been raised as a class action, in deciding whether or not to approve the settlement a court's typical concern is whether the settlement is 'fair, reasonable, and adequate' to class members, FED. R. CIV. PROC. 23(e)(2) quoted by J Grimelmann, 'The Google Book Search Settlement: Ends, Means, and the Future of Books', The American Constitution Society for Law and Policy (April 2009) 15. It must also be consistent with the public interest. *Bailey v. Great Lakes Canning, Inc.*, 908 F.2d 38, 42 (6th Cir. 1990).

and then to co-ordinate payments to rights holders. Google will pay USD $34.5 million for the set up costs of the Registry which will thereafter be funded through 63% of the income stream received by Google through its commercial operation of the Books database. The Registry will be managed by equal numbers of authors and publisher representatives. No other stakeholder class (e.g. libraries; readers; academic users) will be represented or have a vote.

Google will obtain its revenue stream through selling access to the database of books which will mainly be those protected by copyright but out of print. Access licences will be available to educational institutions, libraries (free viewing will be giving via one terminal) and consumers. Revenue will also be earned through advertising. Books in the public domain will continue to be made available free of charge. Books which are protected by copyright and in print will not be available in the database unless the rights holder opts to have them included. Rights holders can exclude their books from some or all of these uses and can also remove their books altogether from the database (if already digitised) so long as the request is made on or before 5 April 2011. Thereafter a book can be prevented from being made available but cannot be 'de-digitised.' Nor can Google be stopped from digitising it. With respect to books that have already been digitised without permission, Google will make available USD $45 million, and pay between USD $60 and USD $5 for each work.

A. The Views So Far

It has taken a while for comment on the Settlement to emerge, no doubt because the terms are complex. What should come as no surprise to anyone is the self interest of the parties evident in the terms of the Settlement. There are however differences of opinion as to how that self interest should be interpreted. Supporters of Google agree with the search engine that the aim to free the printed word shines through. Those who are more circumspect point to the position of monopoly that will be occupied by Google if the Settlement is agreed and argue that Google's only aim is to dominate this market.[41]

One key aspect of the Settlement concerns so called orphan works. An orphan work is generally understood as a work still believed to be protected by copyright but for which the owner cannot be found despite carrying out reasonable searches. With the ubiquity of digitisation combined with the malleability and ease of re-purposing protected works, so the difficulties posed in trying to find copyright owners have

[41] For a synopsis of the arguments on both sides see J Grimmelmann 'How to fix the google book search settlement' (2009) 12:1 *Journal of Internet Law* 1.

been amplified. This has led, in recent years, to a number of proposals being brought forwards which would give those digitising and making available orphan works some immunity in the event that they used the work but then the rights holder emerged and claimed infringement. One of the most developed was the Orphan Works Act[42] in the US. This measure was proposed after a lengthy study of the issue by the US copyright office and would have limited the amount of damages a rights holder could claim from someone making an orphan work available provided a reasonable search had been carried out in trying to find that rights holder.[43] The process stalled in the Autumn of 2008 as political attention focussed on the economic crisis. Other jurisdictions are also working on the problem. In Europe there have been extensive discussions and meetings to examine possible solutions to this issue. One of the most recent culminated in a report on orphan works promulgated by the i2010: Digital Libraries High Level Expert Group.[44] However, as in the US, progress is lamentably slow as focus remains on weighty economic matters.

In essence, the Settlement is a type of orphan works agreement forged by private parties in the face of public regulatory failure. Because this is a class action it has been brought on behalf of all authors who have an interest in a US copyright[45]. In addition the publishers have agreed to drop their action in the event that the Settlement is ratified at the Fairness Hearing. The Settlement thus immunises Google from being sued for past and future reproduction and making available of orphan works and works which turn out not to be orphaned. However, that immunity would apply only to Google and not to any other party who might want to follow this business model – such as Amazon. If other organisations want also to digitise books which they consider to be orphan, while they could do so, they would run the risk of being sued and have no guarantee that they would be able to negotiate a 'safe harbour' similar to that granted to Google.

Another key and related issue is that of payment. As indicated, Google will make available USD $45 million for digitisation that has already occurred, and then give 63% of future revenues to the Registry for distribution amongst copyright owners. Many of the books already

[42] HR5889 and related Bill S 2913.

[43] The full report and other information on Orphan works is available at http://www.copyright.gov/orphan/

[44] i2010: Digital Libraries High Level Expert Group – Copyright Subgroup. Final Report on Digital Preservation, Orphan Works, and Out-of-Print Works. 04/06/08.

[45] Because of the Berne Convention and national treatment, so the nationals of all signatory states to the Berne Convention will have US copyright in their published works. Berne Convention Article 3. In May 2009 there were 164 Contracting Parties to the Berne Convention.

digitised are likely to be orphan works.[46] After five years the revenues will be distributed amongst the right holders who have registered with the Registry and to defray the costs of the Registry. There is thus a conflict of interest as between those who have signed up to the Registry and 'owners' of orphan works.

Others have raised serious questions as to whether those who initiated the Authors Guild action could possibly be said to represent authors as a class. It was a question Google raised in the initial court papers but dropped as settlement was reached. In the Settlement, the Authors Guild claim to represent everyone who has an US copyright interest in a book.[47] All authors are then bound by the deal unless they opt out. But in order to obtain a deal that bound all of the members of the class, Google only had to negotiate with ten individuals. Would be competitors then face an insurmountable hurdle who might have to deal individually with aggrieved authors and, ultimately, be faced with potentially expensive law suits in order to compete in the market and drive down the price of the books and of access.[48]

The reality is that there were significant pressures on both sides to settle this action. For Google, had they been sued and lost, potential payments for each and every digitisation of a book that had been carried out without permission might have amounted to in excess of USD $100,000. For the Authors Guild there was the unthinkable outcome that a court may have found Google's behaviour to be fair use. And for both there was the prospect of years, and years, and years, of litigation as the case progressed its way through appeal after appeal. Such uncertainty is expensive not only in financial terms, but also in terms of the energy and focus that could be much better expended elsewhere – in innovating, in growing the business, and in concentrating on the creation of new works. So private parties have come to a negotiated settlement where regulation failed, 'While the public authorities slept, Google [and the Author's Guild] took the initiative.'[49]

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[46] Google has spent $7m on a campaign to alert authors to the settlement – so many may come forwards. See Grimmelmann supra n. 41 p 14 who quotes that a notice has even gone to Nauru Bulletin (circulation 700). But there will be many other authors who may not.

[47] Supra n. 40. Grimmelmann p3. Indeed, eventually the Authors Guild will represent all of those who sign up to the Registry – but all authors will be included unless they opt out. That would include me – and your copyright in your many and varied works, Thomas, which will last until the end of 2078.

[48] P Samuelson, 'Legally Speaking: The Dead Souls of the Google Booksearch Settlement', *O'Reilly Radar*, 17 April, 2009. http://radar.oreilly.com/2009/04/legally-speaking-the-dead-soul.html.

[49] R Darnton, 'Google & the Future of Books' (February 12, 2009) 56:2 *New York Review of Books.* Quoted here in a different context.

Or that is how it seems. At the time of writing opposition to the Settlement was starting to build. Not only has the date for indicating claims to Google been moved back by four months and the Fairness Hearing moved to October, but in addition there are reports that the Department of Justice in the US has been talking to Google about the anti trust concerns it has with regard to the position of monopoly in which the Settlement would place Google.[50] It remains to be seen whether the Fairness Hearing takes place and, if it does, whether the Settlement is ratified. Thus the jury is still out: has Google sought to free or to monopolise the printed word?

IV. Conclusion

Lieber Thomas

So what would you make of this Thomas? I chose the subject because I thought it would interest you on many levels. You were admirably innovative in your publishing business and would have applauded Google's proactive strategy. However you would not have liked your initiatives to have been copied without your consent (even had the Settlement been applicable to your business). Perhaps, and knowing the delight you took in negotiations, you might have come to an accommodation with Google. Perhaps, and knowing how fiercely you defended your interests and the interests of those loyal to you, you would not. But there are deeper links with your work. You have argued that in international business the norm in relationships is self ordering and attempts at regulation are unlikely to be effective.[51] However, you also argued that law can help developments particularly in economies in transition, providing credibility to commitments and enabling deals that would not otherwise be done to be done at an affordable cost.[52] My investigation has been in the context of business models in transition and private ordering in the face of the failure of regulation. Here, rather than being faced with a transitional economy, we are confronted with markets in transition responding to rapid changes in the form of digitisation and the accessibility of creative works made possible by the Internet. High, seemingly insurmountable hurdles face those who would seek to re-shape the regulatory framework governing the relationships between

[50] See for example the Wall Street Journal http://online.wsj.com/article/SB12409563997146 5549.html#mod=rss_whats_news_technology.

[51] In many places including your contribution to the Liber Amicorum for Professor Ignaz Seidl-Hohenveldern – in honour of his 80th birthday (G. Hafner, G. Loibl, A. Rest, L. Sucharipa-Behrmann and K. Zemanek (eds), 1998 Kluwer Law International). Your contribution: A Requiem for the 'New International Economic Order': The Rise and Fall of Paradigms in International Economic Law and a Post-Mortem with Timeless Significance', 771–804.

[52] *Ibid,* 800.

the parties. Witness the endless debates surrounding orphan works and attendant attempts, but so far failures, to legislate discussed above. In response to this regulatory failure the parties have sought to fill the void through private ordering. In this case, however, the law may not give the support to the negotiated settlement between those parties in the way you argue it would in transitional economies. Transitional markets within mature economies are weighed down by their regulatory frameworks. This makes supporting innovation at the grass roots more complex and likely to be subject to vested interests. And so with the Settlement we have those whose interests will be affected but who are not a part of the charmed inner circle deeply concerned that their interests are being trampled upon. On the other side, elements of the Settlement are likely to be tested against parts of the external regulatory umbrella, in this case the complex US anti trust system. What then if the Settlement fails these tests? What if grass roots objections and anti trust concerns prevail and the legislative initiatives fail to pass the regulatory hurdles? In mature economies and transitional businesses are we really to see the law unable to support innovation either at the level of private ordering or public regulation? If that is to be the case, what then is the place for the law?

I don't have the answers for these things. But these are the things that we, Thomas, would have discussed, analysed, argued about, fought over and through this dialogue reached a greater understanding and appreciation of the complexity of legal life. Lieber Thomas. How I miss our dialogue.

Legal Issues of OPEC Production Management Practices: An Overview

Melaku Geboye Desta*

I. Introduction

The last time I saw Thomas, on 29 September 2008, at a Centre lunch especially organized for a colleague's retirement, one of the issues we talked about was a conference in late October where both of us were scheduled to attend as speakers. The conference went ahead, but the day that promised to be one of those wonderful occasions where I would have the privilege of sharing a stage with that intellectual giant became another day of mourning in which virtually every speaker spent significant amount of their allotted time paying tributes to a great teacher, a resourceful and challenging thinker, a prolific writer, a generous mentor and most of all a wonderful human being. This paper is based on the presentation I made at that Conference.[1] Although it might look too narrowly focussed on OPEC production management practices, the intention is to present it as a contribution to the broader debate on the role of OPEC in the international economic system at large, one of the many areas on which Professor Thomas Wälde left his indelible mark. In over seven wonderful years of working closely with Thomas, I marvelled at the unique mix of talents I observed: a child's curiosity to learn new things and ability to say things as they are, the teenager's energy and readiness to take on new challenges, the scientist's dedication and tenacity to find the truth, and the old man's wisdom to share and inspire others. This contribution is my humble way of saying thank you to a great scholar who changed my life for the better, as he did to so many others.

II. Background

OPEC is an organization made up of countries that are net-exporters of petroleum. OPEC countries as a group account for just under half of global oil supplies and over three-quarters of proven crude oil reserves

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[1] For earlier discussions on the subject, see MG Desta, 'OPEC, the WTO, Regionalism, and Unilateralism' (2003) 37:3 *Journal of World Trade* 523–551. Much has happened over the past six years, but the issue has not gone away.

today.[2] With global demand for oil forecast to grow significantly over the next two decades, OPEC's share of the market is also forecast to grow. In order for OPEC countries to meet this growing demand, they do not only need to make use of existing production capacity; they will also need to invest heavily in the sector and build additional capacity. But there is also the risk of overdoing this – overproduction today or overinvestment for tomorrow could lead to a fall in oil prices that will damage their interests as producers.

As petroleum exporters, OPEC member states share a common interest in the workings of the oil market but they are also potential competitors. Realizing the potential dangers of uncontrolled competition over their most valuable resource for their mutual economic interests, these countries created OPEC to serve as a forum for the coordination of their petroleum policies, thereby replacing potentially damaging competition with wilful and mutually beneficial collaboration. The co-ordination and unification of national petroleum policies constitutes OPEC's sole *raison d'être*.

In practice, this usually means that OPEC has to constantly monitor the market and take appropriate actions to move supply levels up or down depending on market circumstances. It does this through the allocation of maximum daily production quotas to its members. The last time OPEC increased production quotas with a view to stabilising the market and bringing down prices was in September 2007 when it decided to raise output by 0.5 mb/d.[3] Likewise, the last time OPEC took a decision to cut production was in December 2008, which removed 4.2 mb/d 'from the actual September 2008 OPEC-11 production of 29.045 mb/d, with effect from 1 January 2009'.[4]

It is this practice of supply management through allocation of daily production quotas that raises concerns among consuming countries. The tempo of the political rhetoric against this OPEC practice and the temptation to try to challenge it seem to go up and down in tandem with crude oil prices on the world market.[5] The legal manifestation of

[2] See, OPEC, *Annual Statistical Bulletin 2007*, 22.

[3] For details on this, see OPEC Bulletin, Vol. XXXVIII, No 7, September/October 2007.

[4] OPEC Secretariat, *151st (Extraordinary) Meeting of the OPEC Conference*, Press Release: No. 17/2008 (Oran, Algeria), 17 December 2008, available at http://www.opec.org/opecna/Press%20Releases/2008/pr172008.htm. It is notable that the decision used as its benchmark the actual production in September 2008, which was higher than the agreed daily production allocations at that time. The OPEC-11 production ceiling for September 2008 was actually 28.808 mb/d. See OPEC Secretariat, *150th (Extraordinary) Meeting of the OPEC Conference: Press Release No 15/2008*, (Vienna 24 October 2008, at http://www.opec.org/opecna/Press%20Releases/2008/150th%20OPEC%20Meeting.pdf.

[5] See, among others, S Weber Waller, 'Suing OPEC' (2002) 64 *University of Pittsburgh Law Review* 105–155; and K Reinker, 'Recent Developments: NOPEC: The No Oil Producing and Exporting Cartels Act of 2004' (2005) 42:1 *Harvard Journal on Legislation* 285–298.

these concerns comes in the form, inter alia, of judicial challenges to OPEC and its member states under national and international law. Two legal avenues have been considered in this connection – an antitrust action for alleged violation of competition law before domestic courts and a possible challenge of OPEC-cum-WTO member states at the WTO. Neither line is new, nor is the possibility of a successful 'judicial' challenge under these avenues any closer to reality than before. Indeed, now that the latest round of price hikes appears to be over, the enthusiasm behind these initiatives is diminished. But, the threat remains and this article is intended to provide an update in three areas – antitrust challenges in the United States, the possibility of international law challenges at the WTO, and national legislative efforts to make one or both of these possible, particularly in the United States.

III. Challenges at the WTO

OPEC as an international organization is not, and cannot be, a member of the WTO. As such, OPEC is not subject to the WTO dispute settlement system. On the other hand, of the 13 OPEC member states today, nine (Angola, Ecuador, Indonesia, Kuwait, Nigeria, Qatar, Saudi Arabia, United Arab Emirates, and Venezuela) are also members of the WTO, while the remaining four (Algeria, Iraq, Iran and Libya) are in the process of accession.[6] All nine OPEC-cum-WTO member countries are potentially vulnerable to challenge at the WTO for any measures they take.[7]

A. The Legal Issues

The key legal question relating to OPEC supply management practices is whether they qualify as export restrictions under GATT Article XI:1, which provides:

[6] For the latest information, see www.opec.org.

[7] The four OPEC member countries that have yet to join the trading system cannot be challenged at the WTO. But given that all of them are negotiating accession, the WTO may still be used to put pressure on these countries. Indeed, the absence of any strict rules on WTO accession means that there is nothing in the rules of the WTO that prevents a WTO member country from making the accession of any of these countries conditional on their renunciation of OPEC-like supply-management practices. According to Raj Bhala, US Senator Charles Grassley tried to do almost exactly that in respect of Saudi Arabia's accession, i.e. making the country's accession conditional on some form of concession relating to its role inside OPEC which 'nearly single handedly raised the price of WTO admission'. See 'Saudi Arabia, the WTO, and American Trade Law and Policy' (2004) 38 *The International Lawyer* 799. For a discussion of how the accession process could be used for the imposition of obligations that go beyond the WTO's existing set of rules, see MG Desta, 'Accession for What? An Examination of Ethiopia's Decision to Join the WTO' (2009) 43:2 *Journal of World Trade* 339–362; and S Charnovitz, 'Mapping the Law of WTO Accession' in M Janow, V Donaldson and A Yanovich (eds), *The WTO: Governance, Dispute Settlement and Developing Countries* (Juris Publishing, 2008) 855–920.

> No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party.

Neither the GATT nor the WTO has ever ruled on the question of whether production restrictions fall under Art. XI, which leaves a degree of uncertainty on the subject.

To start with the text of this provision, Art XI:1 provides an exhaustive list of the measures that *may* be used on imports and exports while it provides a non-exhaustive and widely-phrased list of the type of measures that *may not* be used. There is no doubt that OPEC measures fall outside the scope of the permitted measures – i.e. they are not 'duties, taxes or other charges'.[8] The question therefore is whether OPEC member countries' implementation of their agreement to reduce national production quotas at any given time amounts to 'prohibitions or restrictions ... made effective through quotas, ... export licences or other measures ... on the exportation or sale for export of any product destined for the territory of any other contracting party'. But, one might argue that the answer to this must be simple: we have already said that GATT Art XI:1 provides an exhaustive list of the permissible measures, and if OPEC measures do not fall within this list, they should fall in the non-exhaustive and broad language of the prohibitions.

However, the issue is not as simple as this. Before we classify OPEC measures within the binary language of Art. XI:1, we must first determine whether they relate, in relevant part, to 'the exportation or sale for export of any product destined for the territory of any other contracting party'. The key question is thus whether measures to restrict the production of petroleum are measures on 'the exportation or sale for export of [a] product'. This is where the complexity comes. We know, and OPEC countries do not contest, that the purpose and almost inevitable effect of production cuts is a cut in the amount of exports. A purposive interpretation of this provision would support the broadest possible meaning to the language of Art. XI:1 which discourages the use of any non-duty restrictions on exports 'whether made effective through quotas, import or export licences or *other measures*'. So even if one were to argue that the OPEC measures are not directly about restricting the export of a product and fall totally outside the reach of the trading system, it is undeniable that the effect is the same – i.e. to restrict the amount of exports

[8] The other side of this, of course, is that OPEC countries would be free to use *duties, taxes or other charges* on the exportation of their products if they wish to, but for reasons I have never understood, they do not seem to want to do this.

of the product by deciding to keep an existing production capacity idle and not producing it in the first place. One could further argue that such a broad interpretation goes in line with the trade liberalization objectives of the WTO system itself.[9]

However, it is submitted that the said measures fall outside the scope of GATT Article XI. Indeed, the uncertainty is such that I myself had argued, in a previous article that was published in a peer-reviewed journal, that OPEC measures 'could technically be termed as "quantitative restrictions" in the sense of GATT Article XI:1', but I also went on to argue that such measures 'could arguably be justified under the exceptions provision of Article XX(g)'.[10] Professor Wälde also took a similar view and wrote: 'production quotas such as the ones currently used are "export quotas" under Article XI GATT'.[11]

On further research and reflection, however, I argue here that the measures do not fall within Art. XI in the first place and there will be no need to justify them under GATT Art. XX(g) or any other law. The GATT prohibition of quantitative restrictions on 'the exportation or sale for export of any product destined for the territory of any other contracting party', presupposes that (1) there is a product; (2) the product is ready for exportation, and (3) the product is already destined for another contracting party. None of these presuppositions is met in the case of OPEC production quotas; the quotas apply to a natural resource which becomes a product only after the actual production process has taken place. Until that point, there is no product whose export to restrict, never mind a product that has already been destined for the foreign market. Clearer understanding of the distinction between a restriction on production and a restriction on the exportation of what has already been produced is critical.

B. Production restriction v export restriction

The question of whether or not OPEC supply management practices are permissible under WTO law turns on the question of whether OPEC production quotas amount to export quotas. No doubt that the decision to restrict oil production directly affects the amount of oil that can be exported; but that does not mean that OPEC allocates export quotas between its members.

[9] See also S A Broome, 'Conflicting Obligations for Oil Exporting Nations? Satisfying Membership Requirements of both OPEC and the WTO' (2006) 38 *The George Washington International Law Review*, 409–436.

[10] See Desta supra note 1.

[11] See Wälde, 'International Organisations in the Energy Sector: OPEC' in *OGEL Profiles*, OGEL 2 (2003), available at http://www.ogel.org/article.asp?key=86, visited on 26 April 2009.

Unfortunately, the terminology used by different people to describe OPEC supply management practices is inconsistent, in some cases perhaps deliberately so. For example, as we shall see later, the Bill introduced by US Senator Lautenberg describes the OPEC practice as the establishment of 'export quotas',[12] a term calculated to show that OPEC measures are direct trade measures rather than production measures. However, the same Bill aims to prohibit production restrictions as such rather than just export restrictions.

While the choice of words in the Lautenberg Bill may be calculated, the fact that similar misleading language appears to be used by the WTO Secretariat and even OPEC countries themselves within the WTO does not help. The latest trade policy review report for the UAE states that the country 'may restrict oil exports as a result of its membership in [OPEC]'.[13] In other cases, while the causal connection between OPEC membership and oil export restrictions are not made as explicitly, we find reference to a country's OPEC membership under the 'export restrictions' heading of the trade policy review reports. A good example here is the report on Venezuela which, under that heading, says: 'As Venezuela is a member of OPEC, its oil production is determined by the Government. This applies to production for both the domestic market and the international market'.[14] A similar but less explicit example is the 2007 trade policy review report for Indonesia which, under the same heading on export restrictions, notes: 'Indonesia, as a member of [OPEC], which regulates the world's oil market, has quota arrangements with other countries'.[15] Although none of these documents have any direct legal significance on their own, they might be used by interested parties to support the view that OPEC production restrictions are actually equivalent to export restrictions.

However, equating these two concepts is both wrong and contrary to the prevailing state of international law, which implicitly distinguishes between the rights of a state to decide on what to produce and its right to decide on what to do with a product. The law of international trade administered by the WTO comes into play only after a given natural resource has passed through a production process and been converted into a product ready for exchange and trade. If this law applies to the pre-production stage, it is only to the extent necessary to ensure that

[12] See paras 6 and 7 of the Bill introduced to the US Senate by Senator Lautenberg (See, 110th Congress, 2d Session, S. 2976 (2008)). The Bill declares, inter alia, that the 'agreement among OPEC member nations to limit oil exports is an illegal prohibition or restriction on the exportation or sale for export of a product under article XI of the GATT 1994' and the 'export quotas and resulting high prices harm American families….'

[13] See WTO, WT/TPR/S/162/Rev1, 28 June 2006, p 35, para 66.

[14] See WTO, WT/TPR/S/108, 30 October 2002, p 65, para 136.

[15] See WTO, WT/TPR/S/184/Rev1, 6 November 2007, p 56, para 76.

measures taken at that stage do not affect the competitive relationship on the market between the products that come out of the process.[16] This principle has been reaffirmed several times. To make this point, I will use only three examples taken from three different natural resources – water, fisheries and energy itself – under three different but overlapping international law regimes – NAFTA, GATT, and the ECT.

Water under NAFTA

The International Joint Commission (IJC) made up of US and Canadian representatives and responsible for managing water-related issues between these countries had to confront the question of whether the countries are under any obligation, from NAFTA or the WTO, to allow access to their fresh water resources for export purposes. The IJC conducted a detailed analysis of the issues and concluded: 'it is unlikely that water in its natural state (e.g., in a lake, river, or aquifer) is included within the scope of any of these trade agreements since it is not a product or good. This view is supported by the fact that the NAFTA parties have issued a statement to this effect. When water is 'captured' and enters into commerce, it may, however, attract obligations under the GATT, the [Canada-US]FTA, and the NAFTA'.[17]

Fish under GATT

Likewise, in a GATT case between the US and Canada relating to a Canadian restriction on the export of unprocessed salmon and herring, the parties as well as the panel made clear that GATT rules do not apply to any measures restricting fish catch but only to measures restricting the export of fish after they have been caught. In the words of the US itself, Canada has 'the undeniable right … to conserve fish in the accepted sense of enhancing stocks and *limiting harvesting in order to ensure future yield*'.[18] The US further recognized Canada's sovereign right to 'implement conservation programmes through … [its] sovereign authority *to limit* and require reporting of *catch* …'.[19] The panel, in rejecting Canada's defence that its restriction on the export of raw fish did not fall within the scope of the GATT, also followed the same approach by noting: 'the export prohibitions *do not limit access to salmon*

[16] A good illustration for this comes from the *Canada Softwood Lumber* case where subsidies allegedly provided upstream, in the form of grant of licences to harvest standing trees at below-market prices, which allegedly resulted in actionable subsidies on the downstream softwood lumber exports. For analysis, see G Gagne and F Roch, 'The US-Canada softwood lumber dispute and the WTO definition of subsidy: Case Comment' (2008) 7:1 *World Trade Review* 547–572.

[17] See http://www.ijc.org/php/publications/html/finalreport.html#8.

[18] GATT, *Canada Measures Affecting Exports of Unprocessed Herring and Salmon,* Report of the Panel adopted on 22 March 1988 (L/6268 - 35S/98) 20 November 1987, para 3.8.

[19] ibid, para 3.36.

and herring supplies in general but only to certain salmon and herring supplies in unprocessed form'.[20] This makes it clear that, in the view of the panel, which was also explicitly recognized by the US, Canada would have been within its rights had it been limiting access to fish supplies, i.e. a production restriction, rather than limiting access to already harvested but still raw salmon and herring.

Energy under the ECT

Finally, none other than the Energy Charter Treaty, whose principal objectives include the establishment of free trade in energy materials, products and energy-related equipment, as well as the promotion and protection of investment in the sector, devotes a whole Article (18) to the principle of sovereignty over energy resources. The provision declares in unequivocal terms that ECT parties 'recognize state sovereignty and sovereign rights over energy resources', which 'must be exercised in accordance with and subject to the rules of international law'.[21] More specifically, the Charter stated: 'Each state continues to hold in particular *the rights to decide the geographical areas within its Area to be made available for exploration and development of its energy resources, the optimalization of their recovery and the rate at which they may be depleted or otherwise exploited*, to specify and enjoy any taxes, royalties or other financial payments payable by virtue of such exploration and exploitation, and to regulate the environmental and safety aspects of such exploration, development and reclamation within its Area, and to participate in such exploration and exploitation, inter alia, through direct participation by the government or through state enterprises'.[22]

It is notable that this ECT provision is only a restatement in the energy sector of the general international law principle of permanent sovereignty over natural resources (PSNR). Many leading international law scholars agree that the PSNR principle is a fundamental principle of international law that cannot be taken away very easily. Indeed, Professor Vaughan Lowe mentions the PSNR principle as one of the possible examples for *jus cogens* norms of international law on the same level as the principle for the prohibition of apartheid-type racial discrimination.[23] The ICJ has also, for the first time, ruled that the PSNR principle 'is a principle of customary international law'.[24] Rosalyn Higgins, who wrote in 1994 that

[20] ibid, para 4.7.
[21] See ECT Art. 18:1.
[22] See ECT Art. 18:3 (emphasis added).
[23] See Lowe, *International Law* (Oxford University Press, 2007), p 59.
[24] ICJ, *Armed Activities on the Territory of the Congo (Dem. Rep. Congo v Uganda)*, 19 December 2005, P 77, para 244. For analysis of the significance of this ruling, see R Dufresn, 'Reflections and Extrapolation on the ICJ's Approach to Illegal Resource Exploitation in the Armed Activities Case' (2008) 40 *New York University Journal of International Law and Politics*, 171–217.

'states have a very special position in regard to their own resources'[25] agreed with this pronouncement of the ICJ, of which she was the president.

In sum, it appears clear that OPEC member states are in analogous positions to Canada or the US asserting that trade law, whether from NAFTA or WTO, has nothing to do with the issue of access to their respective fresh water resources in their natural state (e.g. in rivers and lakes) or their sovereign right to determine the rate at which they exploit their fisheries resources. One obvious parallel to the Canadian fisheries case would have been a situation where OPEC member countries would allow production of crude oil but make its exportation conditional on a certain degree of refinement taking place within their borders. What they in fact do is restrict access to the resource in its natural state, i.e. while it is still underground, just as Canada could have done, within its legal rights, if it had limited the amount of fish that could be harvested over a given period. The moment OPEC countries produce the crude and ban its exportation, or make exportation conditional on any further processing within the countries, they would be in breach of their WTO obligations. To the extent they only restrict production, their acts remain outside the scope of the GATT-WTO system, falling instead under the established principle of permanent sovereignty over natural resources.

IV. Antitrust Challenges

Although competition law is a critical element of any functioning market system, including the EU common market, there is nothing like an international competition law treaty.[26] All antitrust challenges we are considering here are thus almost by definition challenges under national law and before national courts. As such, there is every potential for OPEC practices to be challenged under the competition law of any country. To the author's knowledge, this has been attempted so far only in the United States.

The first case was brought in late 1978 by a US labour union, called the *International Association of Machinists and Aerospace Workers*, before the US District Court for the Central District of California, alleging violation of US antitrust laws and claiming damages and an injunctive relief.[27] OPEC itself as an organization and each of its then thirteen members

[25] R Higgins, *Problems and Process: International Law and How We Use It* (Oxford, Clarendon Press 1994) 141.

[26] See MG Desta and NJ Barnes, 'Competition Law and Regional Trade Agreements' in L Bartels and F Ortino (eds.), *Regional Trade Agreements and the WTO Legal System* (Oxford University Press, 2006) 239–264.

[27] See *International Association of Machinists and Aerospace Workers v OPEC and Member Countries*, 477 F. Supp. 553, (September 18, 1979).

were joint defendants. The court dismissed OPEC (the organization) from the lawsuit as a preliminary matter on the ground that it 'could not be and had not been legally served'.[28] The court further dismissed the claim for damages on the ground that plaintiff was at best only an indirect purchaser of oil from OPEC countries – a condition that precludes damages under US law. Finally, the court also dismissed the claim for injunctive relief for lack of jurisdiction under the Foreign Sovereign Immunities Act (FSIA), arguing that defendants' practice of setting conditions for the exploitation of their valuable natural resources was a sovereign function for which they enjoyed full immunity and that it could not qualify for the commercial activity exception.[29] On appeal, the US Court of Appeals affirmed the judgment of the lower court, but on the alternative ground of the 'act of state' doctrine.[30] The court recognised the 'sovereign component' of OPEC countries' price-fixing practices[31] and stressed that 'while the case is formulated as an anti-trust action, the granting of any relief would in effect amount to an order from a domestic court instructing a foreign sovereign to alter its chosen means of allocating and profiting from its own valuable natural resources'.[32]

The second court case in the US was brought before the District Court for the Northern District of Alabama in April 2000 against OPEC as an organisation – and not its members – in the form of a class suit by Prewitt Enterprises, a company which operated a lone gas station in the city of Birmingham, Alabama. Just like the previous case, Prewitt also sought for an injunctive relief under US antitrust law.[33] OPEC failed to appear before the court, which led the court to enter a default judgment finding that OPEC was an 'unincorporated association' under US law and that it had both subject matter and *in personam* jurisdiction over

[28] The court noted that this was because 'FSIA applies only to foreign sovereignties, which OPEC is not; and, IOIA applies only to those international organizations' in which the United States participates''. ibid, at 560.

[29] ibid, at 567.

[30] According to this doctrine, 'the courts of one country will not sit in judgment on the acts of the government of another done within its own territory' and that 'a United States court will not adjudicate a politically sensitive dispute which would require the court to judge the legality of the sovereign act of a foreign state'. See *International Association of Machinists and Aerospace Workers v OPEC and Member Countries*, 649 F.2d 1354, (9th Cir. 1981) 1358.

[31] See ibid, at 1360

[32] ibid, at 361. For a comment, see M Leigh, 'Judicial decisions' (1982) 76 *American Journal International Law* 160 ff. This ruling has since served as an important authority on what the US courts call 'the principle of supreme state sovereignty over natural resources' See *World Wide Minerals, Ltd., et al.* (appellants) *v Republic of Kazakhstan, et al*., (appellees), United States Court of Appeals for the District of Columbia Circuit, 296 F.3d 1154; August 2, 2002.

[33] See *Prewitt Enterprises, Inc. v Organization of the Petroleum Exporting Countries*, United States District Court for the Northern District of Alabama, Southern Division , Civil Action Number Cv-00-W-0865-S, March 21, 2001, pp 4-5.

it.[34] On the important questions of sovereign immunity and the act of state doctrine, the court concluded that 'OPEC is not itself a foreign state or an agency or instrumentality ... of a foreign state; rather, by its own description, OPEC is a 'voluntary intergovernmental organization'... Therefore, neither the Foreign Sovereign Immunities Act ... nor the act of state doctrine ... is implicated in this action'.[35] In a complete reversal of the 1979 precedent, the court went further and ruled that OPEC member countries, although not directly involved as defendants, were co-conspirators with OPEC itself and other non-OPEC oil exporting countries (specifically Mexico, Russia, Norway and Oman), and the supply restriction agreements they entered into were 'plainly commercial in nature' for which 'there can be no sovereign immunity'.[36] According to the court, the commercial activities exception also applied to the act of state doctrine, thus bringing the case 'entirely within the Court's judicial competency, regardless of the identity of the actor'.[37] After finding that these OPEC practices were 'illegal *per se* under the Sherman and Clayton Acts', the court granted an order, valid for twelve months (until 21 March 2002), enjoining 'defendant Organization of the Petroleum Exporting Countries, its officers, agents, servants, employees and attorneys, and those persons and entities in active concert and participation with them ... from entering into any agreements amongst themselves or with third parties to raise, lower, or otherwise determine the volumes of production and export of crude oil ... and/or enforcing the performance of any such agreements'.[38] At this point, OPEC appeared before the district court and moved to vacate the default judgment and injunction on the grounds that OPEC had never been properly served with process, and thus, the court lacked jurisdiction over it. The district court agreed and dismissed Prewitt's complaint for lack of jurisdiction. The US Court of Appeals, Eleventh Circuit, affirmed the dismissal for lack of jurisdiction, again on the grounds that 'service of process on OPEC has not been effectuated'. The Court of Appeals went further and noted that 'there are no means available for service upon OPEC under the Federal Rules of Civil Procedure'.[39]

It was in recognition of the solid precedent established by these cases that plaintiffs in the latest round of cases[40] chose to name as defendants

[34] See ibid, at 18–19.
[35] See ibid, at 9–20.
[36] See ibid, at 20–21.
[37] See ibid, at 22.
[38] See ibid, at 28–29. For a supportive argument, see A Rueda, 'Price-Fixing at the Pump – Is the OPEC Oil Conspiracy Beyond the Reach of the Sherman Act? (2001) 24:1 *Houston Journal of International Law* 56.
[39] *Prewitt Enterprises, Inc. v Organization of the Petroleum Exporting Countries*, United States Court of Appeals, Eleventh Circuit, 353 F.3d 916, 2003-2, Dec. 18, 2003.
[40] The six cases thus consolidated are *Spectrum Stores, Inc. et al., v CITGO Petroleum Corporation*, Civil Action No. 4:06-cv-3569 (Southern District, Texas); *Fast Break Foods, Cont.*

the national oil companies of some of the major OPEC countries and their foreign affiliates on the allegation that these companies are private corporations who use OPEC to engage in price-fixing arrangements amongst themselves. These cases were later consolidated into one and transferred to the federal court in Houston, Texas, for pre-trial proceedings.[41] In their amended and consolidated class action complaint, plaintiffs allege that such national oil companies as Saudi Aramco and Venezuela's PdVSA are 'vertically integrated, multinational conglomerates' that have conspired to fix the prices at which they sell billions of dollars of refined petroleum products in the United States each year.[42] This, they claim, is a violation of the Sherman Act.[43] According to plaintiffs, OPEC decisions to cut crude oil production quotas are a form of 'private and collusive management of price' designed to 'raise, maintain and stabilize the prices of refined petroleum products at levels substantially higher than if the prices resulted from market forces alone'.[44] Plaintiffs argue that their action does not question sovereign nations' ability to manage their natural resources and their targets are 'companies acting in private commerce'[45] in a manner which constitutes a *per se* violation of Section 1 of the Sherman Act. At the same time, plaintiffs argue that all meetings and decisions taken by OPEC member states in Vienna or elsewhere are decisions to fix the price of refined petroleum products taken by companies with commercial operations in the United States.[46]

Each of these arguments was refuted by the 'served defendants' who argued, successfully, that the claim is nothing more than a thinly-veiled

LLC v Saudi Arabian Oil Company, et al., Civil Action No. 4:07-cv-4409 (Northern District, Illinois); *Green Oil Co. v Saudi Arabian Oil Company, et al.*, Civil Action No. 4:07-cv-4413 (Northern District, Illinois); *Countywide Petroleum Co. v Petroleos de Venezuela S.A., et al.*, Civil Action No. 4:07-cv-4415 (Northern District, Ohio); *S-Mart Petroleum Inc. v Petróleos de Venezuela S.A., et al.*, Civil Action No. 4:07-cv-4434 (District of Columbia), and *Central Ohio Energy, Inc. v Saudi Arabian Oil Company et al.*, Civil Action No. 4:08-cv-00241 (Northern District, Illinois). See Memorandum and Order of the US District Court for the Southern District of Texas, Houston Division, in Re: Refined Petroleum Products Antitrust Litigation, Civil Action No. H:07-MDL-01886, 01 January 2009, p 2, available at http://www.gasolinepricefixinglawsuit.com, visited on 23 April 2009.

[41] The cases are collectively referred to as *Refined Petroleum Products Antitrust Litigation* (MDL No. 1886).

[42] In the 2006 case against CITGO, plaintiffs alleged that OPEC and its member states were co-conspirators, CITGO is a 'member of the OPEC conspiracy' and OPEC supply management practices are an 'illegal price-fixing conspiracy'. See Complaint in *Spectrum Stores and others v CITGO,* United States District Court for the Southern District of Texas, Houston Division, Civil Action Number H-06-3569, November 13, 2006, available at http://www.gasolinepricefixinglawsuit.com, visited on 23 April 2009.

[43] See *Refined Petroleum Products Antitrust Litigation* (MDL No. 1886), consolidated complaint of 8 February 2008, para 1.

[44] See ibid, para 5.

[45] See ibid, para 7.

[46] See ibid, particularly the sections on 'class action allegations' and 'violations alleged' from para 43 to 63.

attempt to challenge the sovereign acts of OPEC and other states in the name of challenging the acts of private companies operating in the US. The defendants argued that

> ... oil is the very life blood of OPEC Member States and a key element of the economies of other producing nations. For many of these nations, petroleum is their only significant natural resource and their most important export commodity. The right of each State to exercise unfettered control over its own natural resources is a fundamental attribute of national sovereignty. No foreign nation (and certainly no foreign court) can regulate the production of non-renewable natural resources in another nation. Indeed, every invitation to the U.S. judiciary to intrude upon the sovereign decisions of foreign governments concerning crude oil production has been summarily rejected.[47]

The court agreed with defendants that the complaint was only a disguised challenge to the sovereign decisions of OPEC countries. In the words of the judgment, 'the collusive acts for which plaintiffs seek redress are not agreements made or even joined by the named corporate defendants but, instead, agreements made between foreign sovereign states to limit their production of crude oil'.[48] Invoking *International Association of Machinists v OPEC*, the court ruled: 'Decisions of foreign sovereigns about production levels of natural resources produced within their territorial boundaries – including crude oil – are sovereign acts regardless of whether the decisions are products of unilateral deliberation or consultation with others'. In a resounding victory for OPEC member states and OPEC itself, the Court not only held that plaintiff's claims are barred by the act of state doctrine but also the political question doctrine which makes the claims non-justiciable:

> ... the adjudication of claims that require the court to determine the legality of crude oil production decisions of foreign sovereigns would express a lack of respect for the Executive Branch because of its longstanding foreign policy that issues relating to crude oil production by foreign sovereigns be resolved through intergovernmental negotiation.[49]

In sum, this precedent on the antitrust front and the strong legal arguments on the WTO front make it clear that the long-held doubt about the legality of OPEC production management practices is without foundation. However, we shall see that this is not the end of the matter. A number of legislative initiatives have been taken in the United States to change this legal reality.

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[47] See *Memorandum and Order*, supra note. 40, 2.
[48] See ibid, at 28.
[49] See ibid, at 51.

V. Legislative initiatives still before the US Congress

The discussion thus far establishes that (1) there is by now a solid case law that reaffirms OPEC member states' unquestioned right to manage their natural resources as they wish, and (2) the WTO line of challenge is politically unlikely to be even initiated, and legally even less likely to be successful. However, this state of the law is unacceptable to several politicians, particularly in the US Congress, who are still busy introducing bill after bill to change it. The legislative initiatives still before the US Congress are intended to change both aspects of the above findings – the first by removing the hurdles identified by the courts in these cases, and the second by specifically requiring the government to institute a case against OPEC at the WTO. The legislative initiatives are thus designed to enable a double-pronged 'judicial' attack against OPEC and its member states – one before domestic courts on grounds of alleged violation of antitrust law, and another before the WTO for violation of rules of international trade law.

The bill that has made the most progress seems to be the *Gas Price Relief for Consumers Act of 2008*, which was passed by the House of Representatives by a 324-to-84 vote on 20 May 2008.[50] The bill is intended to amend US antitrust law (particularly the Sherman Act) so it would also apply to measures taken by foreign states and their instrumentalities. In its own words, the bill is intended to make it illegal for

> ... any foreign state, or any instrumentality or agent of any foreign state, to act collectively or in combination with any other foreign state, any instrumentality or agent of any other foreign state, or any other person, whether by cartel or any other association or form of cooperation or joint action — '(1) to limit the production or distribution of oil, natural gas, or any other petroleum product; (2) to set or maintain the price of oil, natural gas, or any petroleum product; or (3) to otherwise take any action in restraint of trade for oil, natural gas, or any petroleum product' when such action, combination, or collective action has a direct, substantial, and reasonably foreseeable effect on the market, supply, price, or distribution of oil, natural gas, or other petroleum product in the United States.[51]

By denying the 'sovereign immunity' defence for foreign states and removing the 'act of state' doctrine in such cases, the bill aims to bring measures taken by OPEC member states in the exercise of their governmental functions within the jurisdiction of US courts.[52]

[50] See 'Gas Price Relief for Consumers Act of 2008 (Engrossed as Agreed to or Passed by House)', H.R. 6074, 110th Congress, 2d Session, 2008).

[51] ibid, Sec. 102.

[52] Note that this is not the first time for such a bill to be introduced. The bill for a *No Oil Producing and Exporting Cartels Act of 2007 (NOPEC)* was also passed by the House of Representatives on 22 May 2007 and sent to the Senate, where it remains. The bill was *Cont.*

On the WTO front, the relevant legislative initiative is known as the *OPEC Accountability Act*. Introduced by US Senator Frank Lautenberg on 6 May 2008,[53] this is only the latest in a series of initiatives intended to require the USTR 'to pursue a complaint of anticompetitive practices against certain oil exporting countries' at the WTO.[54] The Bill notes that gasoline prices have more than quadrupled since January 2002 and accuses OPEC of being a cartel 'engaged in anticompetitive practices to manipulate the price of oil, keeping it artificially high'.[55] After noting that OPEC member states are either full members or observers at the WTO, the Bill charges that 'the agreement among OPEC member nations to limit oil exports is an illegal prohibition or restriction on the exportation or sale for export of a product under article XI of the GATT 1994'.[56]

From this, the Bill proposes actions that must be taken by the US government to curb these

> cartel anticompetitive practices' that include an action by the President to 'initiate consultations with the [OPEC-WTO member] countries … to seek the elimination by those countries of any action that (A) limits the production or distribution of oil, natural gas, or any other petroleum product; (B) sets or maintains the price of oil, natural gas, or any petroleum product; or (C) otherwise is an action in restraint of trade with respect to oil, natural gas, or any petroleum product, when such action constitutes an act, policy, or practice that is unjustifiable and burdens and restricts United States commerce.[57]

Failing this, the Bill aims to compel the USTR to institute WTO proceedings with respect to those countries and 'take appropriate action … under the trade remedy laws of the United States'.[58]

A number of legal questions arise from the ideas summarized above. Firstly, the focus of the Bill on OPEC cartel and 'anticompetitive practices' appears to be the result of deliberate confusion between competition law (or anti-trust law) that falls within the domain of private law and sovereign acts carried out in accordance with inter-governmental arrangements,

explicitly intended 'to amend the Sherman Act to make oil-producing and exporting cartels illegal'. (H. R. 2264, 110th Congress, 1st Session, 2007).

[53] See, 110th Congress, 2d Session, S. 2976 (2008).

[54] Previous initiatives along these lines include a bill introduced to the House of Representatives by Congressman Peter De Fazio (H. R. 4780, 108th Congress, 2d Session (8 July 2004) and another one to the Senate on the same day by Senator Lautenberg (S. 2624, 108th Congress, 2d Session). For comprehensive information on the different legislative initiatives taken in the US, see the Library of Congress at http://thomas.loc.gov/bss/108search.html.

[55] ibid, Section 2, para 4.

[56] ibid, Section 2, para 6.

[57] ibid, Section 3, para (b)(1).

[58] ibid, Section 3, para (c).

which fall within the domain of public international law. The principles of law, enshrined in a number of treaties, jurisprudence, including US case law, and legal doctrine dictate however that collaboration between governments does not equate their sovereign acts to private cartel practices or any other form of anti-competitive behaviour within the domain of private law. Even then, international law does not yet have the equivalent of national anti-trust or competition law. Finally, even if one were to come up with some construction of OPEC member state conduct that equates it to private acts, such as the argument that states are here acting as commercial operators or their national oil companies are subject to private law, the WTO does not have jurisdiction over private anti-competitive behavior.

Secondly, while the Bill claims that OPEC member nations agree 'to limit oil exports' in violation of GATT Article XI, the proposed solution is to seek the elimination by OPEC countries of 'any action that … limits the production or distribution of oil, natural gas, or any other petroleum product'. This is equivalent to arguing that one and the same measure is an export restriction for one purpose (the claim) and a production restriction for another (the relief sought).

Finally, the Bill aims to compel the said WTO proceedings to lead to a situation where the US would be able to 'take appropriate action … under the trade remedy laws of the United States'. Trade remedy laws in the US legal system, as in WTO law, refer to antidumping and countervailing duty laws that aim to combat the effects of private dumping practices and government subsidies. It is not clear what the Bill intends to achieve in this respect given that the Bill itself is triggered by market conditions opposite to what would come from the practice of dumping or subsidies. Nor do the authors of the Bill attempt to make a dumping or subsidies case.

It is thus possible to argue from these three points alone that this Bill should probably not be taken too seriously. But, this Bill is neither the first to reach Congress, nor is the approach advocated by it likely to be successful before the WTO dispute settlement system. Nor, for that matter, is this meant to suggest that the US is ready to take such a step in practice; it is only to argue that the US appears to be the only country where there has been a sustained pressure from lawmakers and other public authorities to persuade, and even force, the government to take such a step against OPEC. It is also worth emphasising that, despite sustained pressure, all available information suggests that the US government is strongly against such a step. To mention just one example, answering a question whether it is 'theoretically possible to use the WTO to get at OPEC', former US Trade Representative Robert

Zoellick replied: 'under WTO rules in general there's no apparent basis to be able to compel people to sell things. … It would be like somebody coming to the United States and saying you know we must dig up more of this metal or that metal or produce more of this or that product'.[59] Indeed, if the US were to bring a case against OPEC countries for not producing, what would be the implication for its decision not to develop the Alaska oil reserves?[60] Once again, it does not look likely any of these legislative initiatives will ever succeed.

VI. Conclusion

It flows from the foregoing discussion that OPEC production restriction measures fall completely outside the scope of national competition law as well as WTO law. The antitrust line has been firmly established now, at least in the United States, but the WTO line still leaves room for uncertainties. I am of the view that it is unlikely a WTO claim will be brought against an OPEC country challenging its production management practices, and if one were to be brought, it is unlikely to succeed. However, until the WTO dispute settlement system develops some form of direct 'precedent' on this subject, OPEC countries should take all necessary steps to protect their interests within the trading system. This will require a more active and coordinated engagement at the WTO, including pushing for a WTO agreement on international commodity agreements that can encompass producer-only arrangements – an issue that could not be developed further in this paper for space limitations. Finally, the principle of permanent sovereignty over natural resources, already recognized as a principle of customary international law by the highest judicial authority in international law, provides the best legal protection for the practice of production quota allocations among OPEC member states.

[59] See, *Press Conference*, Washington, DC, May 27, 2004, available at http://www.ustr.gov/assets/Document_Library/Transcripts/2004/May/asset_upload_file778_3270.pdf. See also Broome, supra n. 9.

[60] Aubrey McClendon, chief executive of an Oklahoma-based energy company, was quoted to have said that it is 'hard to fault Mexico or Saudi Arabia for not developing their fields to the max when the U.S. declares its own territory off-limits'. R Lowenstein, 'What's Really Wrong with the Price of Oil' in *The New York Times* (19 October 2008).

Dispute Prevention and Dispute Settlement: Reflections on Discussions with Thomas Wälde

Hew R. Dundas*

I. Introduction

In this memorial essay in honour of Thomas Wälde (whom I had known for nearly 20 years), I will address two related areas of common interest in respect of which we had exchanged views on several occasions (mainly off-line), sharing broadly common conclusions. I learned a great deal from such interchanges and am grateful for the honour and privilege of this opportunity to try to preserve in print matters where I benefited from his intellect and his wisdom.[1]

First, we refer today to Dispute Resolution, principally in the context of arbitration, but also in the context of Alternative Dispute Resolution (ADR), which requires either (a) an arbitral tribunal or some other neutral[2] to resolve the dispute by making a determinative decision or (b) a mediator (or other category of neutral) to assist the parties to resolve the dispute for themselves but, in either case, a dispute is presumed to have arisen which requires resolution. Thomas and I shared a strong interest in dispute avoidance and dispute management and our discussions generally reached a common conclusion in principle.

Second, in most common law thinking a judge or an arbitrator is charged with the responsibility of resolving a dispute by making an enforceable decision and, in the eyes of some, should not engage in any part of the range of 'touchy-feely' mediation-related processes which are available. Thomas and I were both very well aware of §278 of the German Zivilprozeßordnung,[3] the comparable 'German Approach' in arbitration whereby a tribunal offers preliminary views at certain stages in the process enabling parties to reassess their positions

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[1] I accept responsibility for the content of this essay; any errors or omissions are mine alone.

[2] eg Expert Determiner, Adjudicator or other.

[3] This states: '1) The court shall at any stage of the litigation seek an amicable agreement of the entire action or parts of it. (2) Before the oral hearing of the case, there shall be a conciliation hearing...'. Informal translation by a colleague, adapted by me. I accept responsibility for any mistranslation.

with a view (inter alia) to their converging on settlement,[4] and the existence in some institutional rules, e.g. those of CIETAC[5] and Beijing Arbitration Commission,[6] whereby the tribunal becomes a mediator or conciliator, reverting to acting as tribunal if the mediation/conciliation is unsuccessful.

I will comment hereunder on some of these issues as Thomas discussed over the years; his style was very much to pose questions to stimulate debate and I hope that my brief observations will do so likewise.

II. Dispute Prevention, Dispute Avoidance and Dispute Management

Disputes occur all the time, across the whole range of economic and commercial activity. Engaging in disputes is essentially a non-economic, non-productive activity; while monies might well be spent on legal fees and other costs, no dispute is a worthwhile or productive activity for commercial enterprises. At best, a party recovers monies to which it was entitled anyway, at worst the fruits of economic activity are lost even before the legal bills arrive. Further, for small and medium enterprises (SMEs) substantial management time, otherwise economically productive, can be wasted on conducting the dispute. It follows that effective dispute avoidance/prevention techniques are the key to minimising such wastage.

The principles of modern mediation were laid down in studies of corporate behaviour.[7] not of dispute resolution, and in my view it is both possible and obligatory for management to create a corporate culture which seeks to embed in all staff the necessity to avoid wasting time and resources on disputes or other argument. In my early days in the oil industry (late 1970s/early 1980s), the approach to contract negotiation and contract management was strongly, even fiercely, confrontational but in the later 1980s the (UKCS[8]) oil industry (and other sectors) realised that there was a better way and various forms of contract emerged (e.g. partnering, gain-sharing and others) which sought to align the interests of client, main contractor and sub-contractors. This had the unsurprising consequence of reducing the scope for disputes.

[4] See, in particular, the very significant and highly-influential article by Hilmar Raeschke-Kessler, 'The Arbitrator as Settlement Facilitator' (2005) 21:4 *Arbitration International* 523. See also below regarding Early Neutral Evaluation.
[5] China Internatioenal Economic Trade Arbitration Commission.
[6] Article 39 of the 2008 BAC Rules.
[7] eg the classic 1981 book *Getting to Yes* by Roger Fisher and William Ury of the Harvard Negotiation Project.

In my career in the oil industry, we (i.e. my various employers and, later, my clients) never litigated, never arbitrated once; in fact we never engaged in any formal dispute resolution process, not even mediation, expert determination or other. Why not ? At the outset in my last company we were short of cash and every available dollar had to be ploughed into exploration. Litigation budget ? I have never seen one. A budget for external legal advice ? On oil & gas matters, in those days we kept the great majority of the work in-house. Why is this relevant ? The answer is very simple – with no budget for litigation or arbitration (and no time to spend on it) we had to resolve our own problems ourselves and, without any training or literature (as is easily available now, 15-20 years later), we had to 'make it up as we went along'. Settlement was always the driver, not least because in most cases time was paramount and the principle 'cash today and let's move on' was regularly applied.[9]

Similarly, when I first ventured abroad to negotiate with foreign state oil & gas companies (SOGCs) or Ministries of Energy/Hydrocarbons, my company's approach focused on co-operation, shared goals and the common good; our opening question in negotiations was normally 'what do YOU want from this contract ?' whereas some of our colleague companies effectively said 'we are Big Oil Inc/PLC – these are our standard terms – sign here'. Not only did this lead to smoother and faster negotiations for us,[10] it created a collaborative atmosphere which stood us in good stead in subsequent years, in particular in minimising the scope for disputes. In several instances difficulties were encountered which might have led to dispute and one successful solution was to park the issue temporarily and enlist the assistance of the UK Ambassador who would then have an off-the-record chat with the appropriate Minister and – lo ! the problem (usually) disappeared.

One dispute prevention approach in international contracts in which Thomas and I held a common strong belief was that of involving a neutral in the contract negotiation phase, particularly in resource development projects between foreign investors and host states with, perhaps, less experience and/or sophistication. I had one such negotiation made very difficult by the lack of communication, largely born out of the SOGC's inexperience. The concept is that a neutral (sometimes called a 'project neutral') sits in on the negotiations much as a mediator does but, perhaps, with a more reserved, less overtly facilitative role. He/she

[8] United Kingdom Contiental Shelf.

[9] This has an interesting echo in today's recessionary times: settlement rates in arbitration have reportedly increased sharply in recent months, probably because, in commercial terms, the choice between hard cash now or an arbitral award in 1-2 years' time against an insolvent respondent is an easy one.

[10] eg an entire PSC in four days.

can assist joint discussions and can be available to caucus with each side to deal with questions and issues arising; of course, the confidentiality principle applies to such caucus sessions. Issues which in my case aroused suspicion or other forms of concern could have been dealt with by the appropriate individual (necessarily someone with vast experience in oil & gas matters and with commensurate international stature in the industry) reassuring the appropriate side that what was being proposed was within the normal spectrum of allowable possibilities as seen by international oil & gas industry practice.[11] The neutral would often be able to identify zones of agreement in difficult areas and gently steer the parties towards them. The parties jointly can benefit from the valuable advice available from the neutral who is, by definition, a significant data resource. The cost of such an individual for (say) one week of negotiations is minimal in comparison with the likely avoided costs of any future dispute.

There is another use of a neutral which I believe has significant value in minimising the likelihood of disputes, that being Early Neutral Evaluation (ENE). While there are many forms of ENE, one model in particular commends itself: one English judge[12] (now in the Court of Appeal) offered a procedure whereby the parties each made written submissions not exceeding (usually) 20 pages and they could jointly submit no more than (usually) 50 pages of supporting materials e.g. a copy of the contract. All these submissions were required by 1630 on a stated date. The Judge would consider the submissions overnight and would see the parties in chambers the following morning at 0930 whereupon each would have 10 minutes for an oral submission then the judge would give them his opinion in 10 minutes (court business commences at 1000). After that the parties were free to do what they wished, whether that was to litigate, arbitrate or settle.

Why is this process of any use? First and simplest it is both free and very rapid and there is an effective limit on how much the parties can spend in preparing for it. Second, the parties have acquired, even if in short order, the opinion of an experienced commercial judge and that opinion, unless overwhelmingly in one's favour, must cause the parties to question their own positions seriously. Thirdly, it is conventional wisdom that those closest to any dispute are least likely to be capable of taking any objective view of it (they have too much personal investment in winning (or, perhaps more importantly, not losing)). Fourth, if face is to be saved and egos protected, the process offers a way out of entrenched positions since individuals can defer to the judge's opinion

[11] A similar mechanism is seen in some forms of construction contract.

[12] The English Commercial Court has offered ENE for a number of years but the take-up to date has been small.

(e.g. 'Mr CEO - we think our case is strong but, since the judge seems less impressed, we should look for another way out'). Fifth, the process is very similar to the reality-testing technique which is an integral part of mediation. Of course, ENE does not require a judge (or even a retired one) and there are potentially many instances in the oil & gas industry where an ENE or similar opinion by an experienced practitioner can have the same effect.[13]

Based on my experience in practice, the key requirement for effective dispute management is that the principal driver must be the drive to settle. 'Win at all costs' might have been effective in the commercial Stone Age but is not in the 21st century.

If the parties cannot or will not drive towards settlement on their own, can arbitral tribunals play a role?

III. Dispute Settlement by Proactive Judges and Tribunals

I have referred above to §278 of the Zivilprozeßordnung.[14] In 2006 the Technology and Construction Court (TCC), a division of the English High Court, issued a discussion document proposing that Judges could act as mediators or other ADR neutrals in appropriate cases,[15] this was greeted with a storm of protest with emotive phrases such as 'this will be the death of justice' being bandied around, this apparently insular response appearing to be based on unfamiliarity with foreign legal systems. However, the essence of the TCC proposal was that the Judge should take a pro-active settlement-focused role without specifying what that role should be i.e. leaving it flexible – perhaps ENE is appropriate? Can issue X be hived off to Expert Determination? And Issue Y to mediation?

An informal survey of approximately 30 jurisdictions sought to ascertain whether there was any equivalent of ZpO §278 and, if so, how it functioned. Unsurprisingly (as civil law jurisdictions), among others Austria, France, Italy, Switzerland, Poland, Lithuania, the PRC, and Argentina have some equivalent of §278; in contrast, Belgium, the Netherlands and Indonesia do not, although there was recently a pilot

[13] I am aware of one such case were an oil industry expert's ENE opinion was ignored causing one party to incur very significant costs which would have been avoided by making constructive use of the opinion. I am aware of another (not ENE but the principle is the same – dispute avoidance) where expensive litigation was prevented by a one-line opinion by one party's own expert.

[14] It is important to appreciate at this point that there is no 'caucusing' in the ZpO §278 model.

[15] In the TCC model, a Judge-mediator would not sit in any subsequent trial.

scheme, similar to §278, in the Netherlands. The responses to the survey showed much less §278-style activity in common law jurisdictions although in Singapore, judicial mediation/conciliation occurs in certain cases, perhaps reflecting the very different cultural significance of conciliation in Asia. Furthermore, in Texas, some judges reportedly interpret their case management powers as extending to mediating (and they do so) and in New York some judges try to settle the case as part of their regular job but do not conduct ex parte discussions with the parties. In England, there are hints[16] of such activity and in practice some judges do lean on parties in various ways, some subtle some not; in Scotland there is current discussion of a limited expedition into ZpO §278 territory but no substantive equivalent yet; and in Australia, there appears to be no equivalent either in part, because mediation (i.e. outside the court) is proving very successful. There were widely conflicting opinions from German (and other) lawyers of the value of the §278 (or equivalent) process with some strong approvals, others quite the opposite.

Some responses referred (in varying language) to 'judicial bullying' to coerce the parties into settling,[17] possibly to show the judge in a good light with a high settlement rate,[18] possibly because the judge-settlor wanted to impose his/her view of the case on the parties, possibly to thin out the court docket. However, it would seem self-evident that no party can be forced into an unsatisfactory settlement so, whether 'judicial bullying' or otherwise, it is not at all obvious that there is any valid objection to the process.

Given the role of judges around the world in promoting or facilitating settlement, what then should or can an arbitral tribunal do? Dr Raeschke-Kessler[19] has given us an excellent exposition of the 'German approach' but, in contrast, the traditional English approach (as I was taught) was to avoid any involvement in this area on the basis that the tribunal had been appointed to *decide* the dispute and were not authorised to do anything else, therefore to do so ran the dual risks of breach of one's obligations under the Arbitration Act 1996 and breach of contract. However, this line of argument is ill-founded; first, the Act is

[16] Refer CPR Section 1, especially 1.4(2)(e) and (f).

[17] An anecdote tells of a retired English House of Lords judge (acting as mediator, not as judge-mediator) bullying parties into rapid settlement of a difficult case; reportedly, he identified significant weaknesses in each party's respective cases so that they settled before 11am on the first day of 'mediation'. 'Mediation' it may not be, successful it certainly was but. certainly, the way I was told the story (by a Solicitor to one of the parties) was in the context of admiration (even if grudging) for the Judge's achieving an expeditious and acceptable result at minimal cost to the parties.

[18] Thomas had an excellent anecdote here of a judge somewhere (I do not recall any details, and certainly not of which jurisdiction) who was promoted all the way to his country's Supreme Court on the back of a high settlement rate whereas a cynic might have observed that the more cases he/she settled, the fewer judgements he/she had to write.

[19] Cf fn 4 supra.

> ... founded on the following principles: (a) the object of arbitration is to obtain the fair resolution of disputes by an impartial tribunal without unnecessary delay or expense'[20] and '[t]he tribunal shall: (a) ... (b) adopt procedures suitable to the circumstances of the particular case ... so as to provide a fair means for the resolution of the matters falling to be determined.[21]

Resort during arbitral proceedings to some ADR processes to resolve some or all of the issues breaches neither s.1(a) nor s.33(1)(b), particularly if such resort save time and expense.

However, in England there is a potentially significant problem caused by the decision in *Glencot v Barrett*[22] where an adjudicator,[23] at the request of the parties (and after taking legal advice), took off his adjudicator's hat and became a mediator; the mediation did not resolve all the issues and, as agreed, the mediator/adjudicator resumed the adjudication. Subsequently one of the parties objected and the adjudicator's decision was set aside for reason of loss of impartiality. Read one way, *Glencot v Barrett* is, at worst, fatal, at best, highly problematic to the tribunal considering engaging in mediation or other forms of ADR; read another, it is very much restricted to its facts and could be distinguished in practice from any future case particularly where the parties had expressly agreed a certain procedure (e.g. in an arbitration in London applying Article 39 of the Beijing Arbitration Commission Rules). In any event, there remains an unresolved difficulty.[24]

There are two extremes of approach to arbitrators bringing ADR processes into arbitration: one is the narrow (and defensive) position identified above, the other is to take the initiative (in appropriate circumstances – this requires very careful judgment) and not be concerned about challenge. In one arbitration in Scotland (where even judges have no power (as in England) even to persuade parties to mediation, let alone order them to do so) I issued an order that was tantamount to being a mediation order; was this legally enforceable? No. Did it achieve its purpose? Yes, the parties duly tried mediation even if it proved unsuccessful.

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[20] Section 1(a) Arbitration Act 1996 (UK).
[21] ibid Section 33(1)(b).
[22] *Glencot Development and Design Co Ltd v Ben Barrett & Son (Contractors) Limited*; [2001] EWHC 15; TCC [2001] BLR 207.
[23] Adjudication is a statutory process under the UK's Housing Grants, Construction and Regeneration Act 1996 applicable only in the onshore construction industry. In most significant regards, the adjudicator conducts him/herself much as an arbitrator would hence the applicability of Glencot in arbitration.
[24] Some of my colleagues operate Med-Arb processes but none has a valid solution to the Glencot difficulty and all rely on no party challenging the ultimate award.

In another case (in England, as sole arbitrator) I was faced with a sub-issue only barely, if at all, capable of decision by an arbitrator; in my award on liability I ordered the parties to meet and negotiate the issue (they had tried negotiating it before but had run into insuperable obstacles, one of which was the truly astonishing degree of enmity between the opposing CEOs) and, in doing so, I set the starting point of the negotiations (i.e. a specific point in time three years previously before the breakdown), the agenda and, most importantly, ordered two specific individuals from each side (i.e. thereby excluding the two CEOs) to participate. Was that order valid and/or enforceable? Almost certainly not. Was it successful? Yes, the resumed negotiations were completed to mutual satisfaction in less than a day. Was my award open to challenge? Probably. With *Cable & Wireless v IBM*[25] in mind, how would (for example) Colman J have dealt with the challenge? I believe very supportingly since what the parties wanted was a resolution of their disputes which is precisely what they got.

The case referred to in the previous paragraph gave rise to another idea which, to my knowledge, has never been tried in practice but which seeks to bridge the cultural divide between the German/Chinese approach and the post-Glencot English approach. That case had several elements which almost begged for some form of mediation and ultimately the parties did indeed settle in mediation; in the early aftermath of the Glencot decision, I did not consider it appropriate to stray too far off the narrow track (I would not hesitate now) and did not. However, had a mediator sat alongside me (ie he/she would have seen all the papers and heard all the submissions and witnesses), then there were instances in the proceedings where mediatable issues arose at which point the arbitrator would retire, the mediator then conducting a mini-mediation of those issues and resuming the arbitration with those issues either resolved or still in play in the arbitration with the arbitrator not party to private exchanges between the parties. In this specific case, the whole dispute could have been resolved in a week; of course, by no means would every case be suitable for such an approach, but some will be. Further, a number of procedural matters would have to be dealt with, in particular the mechanism for switching from arbitration to mediation and back again. In the words of the old adage, 'nobody ever climbed Mount Everest just by looking at it'.

In summary, I see great potential for tribunals to take a more pro-active role in settlement to the ultimate benefit of the disputing parties. We should learn from other jurisdictions and should not fossilise the limitations inherent in our own ones.

[25] *Cable & Wireless PLC v IBM United Kingdom Ltd*; [2002] EWHC 2059 (Comm).

IV. Conclusions

In this essay I have sought to highlight some issues and questions which have arisen in my experience and in respect of which I had enjoyed the benefit of discussion with Thomas. I do not pretend to have all (even any!) of the answers but I offer these thoughts and ideas for your consideration in Thomas' memory.

The Wisdom of International Commercial Mediation and Conciliation

William F. Fox*

I. Introduction

Mediation and conciliation[1] are two alternative dispute resolution processes that garner a great deal of praise in the abstract. One of the leading legal academicians in the United States, the late Lon L. Fuller of Harvard Law School, wrote a seminal article nearly forty years ago commenting that mediation is a 'form of social order'.[2] Elaborating on this idea, Professor Fuller went even further to acclaim mediation as 'directed, not toward achieving conformity to norms, but toward the creation of the relevant norms themselves'.[3] We all recognize that mediation in one form or another has been around for thousands of years. Among other things, mediation has roots in religious beliefs and practices. A number of writers have identified the religious antecedents of modern mediation in the Qur'an and Shari'a Law as well as the Bible and in Buddhism and Hinduism.[4]

Mediation has been lavishly praised by people of the academy, although they themselves often disavow it in favor of take-no-prisoners litigation when it comes to resolving their own disputes. The academic literature is filled with paeans to mediation, asserting, among many other things, that mediation 'is deeply attuned to issues of justice'.[5] A look at some of the recent literature finds an overabundance of words such as 'self-determination', 'party empowerment', 'human fulfillment'

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[1] Later in this chapter, I distinguish between mediation and conciliation even though in most of the scholarly writing on this topic, the two terms are treated as synonyms. In this chapter, unless it is important to make the distinction between mediation and conciliation, I will use mediation to cover both processes.

[2] LL Fuller, 'Mediation--Its Forms and Functions' (1971) 44 *S.Cal.L.Rev*. 305–6.

[3] ibid.

[4] A statement attributed to the Prophet Mohammed emphasizes a value even higher than that of fasting, charity and prayer: 'It is the conciliation of people'. Hands-on mediation has been documented more than 2000 years ago in China. Jerome Alan Cohen, 'Chinese Mediation on the Eve of Modernization', 54, 1205 (1966).

[5] See, e.g., JM Hyman & LP Love, 'If Portia Were a Mediator: An Inquiry into Justice in Mediation' (2002) 9 *Clin. L. Rev*. 157–8.

and 'transformative'.[6] Some of this writing seems to nearly swoon over the benefits and advantages of mediation with a consequent near-demonizing of, typically, litigation – without, of course, paying too much attention to mediation's weaknesses and shortcomings. It is not too much to say that mediation in much of the literature has been oversold. Nor can we deny that a fair amount of the literature on mediation appears to take on a faint left-wing tinge. There are a number of mediation articles that urge a redistribution of power from corporate and financial interests to the 'people' and that urge mediation as an indispensable tool for achieving world peace. This ideological tilt may be pleasing to certain writers and readers but it has not done mediation itself much good.

Perhaps because of the overselling of mediation and the ideological baggage that it has accumulated, selling the idea of mediation to the business community, particularly the Western business community, has been far more difficult. It may be that business executives and lawyers are simply comfortable with tradition. From their first year in law school, fledgling lawyers are educated in the language and techniques of litigation. When we look at television programs and movies, at least in the United States, we see a number of highly popular productions that feature dynamic, feisty (but frequently troubled) courtroom attorneys. At the same time, we are hard-pressed to identify a popular television program featuring a competent, successful mediator as the central character. It is clear that much of the ideology and the overdone sales pitches involving mediation turns off hard-nosed business executives who instinctively gravitate to the bottom line. It may also be that many business executives and lawyers simply do not know very much about mediation – a tragedy when one considers that quite a few business executives and lawyers are skilled negotiators and negotiation lies at the heart of mediation. There are exceptions, of course. The late Professor Thomas Wälde, whom this Festschrift honors, had a passion for mediation and conciliation and toward the end of his life attempted to sell it to the international business community. This article is an attempt at continuing the Wälde sales pitch.

But no sales pitch can be successful if the sales person does not appreciate both the strengths and weaknesses, the pros and cons, of his or her product. There is no question that mediation can be a highly-effective, highly-efficient business tool but only if it is applied to a proper controversy in the company of a skilled mediator with parties to the mediation who *want* to be there and who are willing to proceed in good

[6] The reader will forgive me if I do not provide actual sources for these terms. I am not trying to chastize or embarrass individual writers but merely to cite some of the over-the-top vocabulary that frequently accompanies writing on mediation.

faith. So we must examine both the achievements and the shortcomings of mediation to properly understand and utilize it.

II. Should There Be a Distinction Between Mediation and Conciliation?

Consider that Party A and Party B have a dispute. To resolve the dispute, A and B engage the services of a mediator to assist them in resolving their differences. The mediation itself might be best defined through a diagram:

Described narratively, a mediator is a neutral person who works with both disputing parties to *assist* them in resolving their dispute. A more comprehensive definition is: 'A private, voluntary dispute resolution process in which a third party neutral, invited by all parties, assists the disputants in: identifying issues of mutual concern, developing options for resolving those issues, and finding resolutions acceptable to all parties'.[7] When we look at the arrows in the diagram, we see that the mediator communicates with both parties and the parties communicate with the mediator. In some mediations, the mediator will chose to step aside and let the parties talk to each other without the mediator being present. Whatever specific techniques are used, the key to mediation is the simple fact that the *parties* decide. The mediator merely assists.

Is conciliation different? In most of the dispute resolution literature, conciliation is used simply as a synonym for mediation.[8] Some of the literature suggests that while mediation and conciliation are essentially the same, the term *conciliation* is the preferred term in international parlance.[9] There are other articles in which the author creates his or her own definition for each of the terms. There have been occasions when one expert will define the terms in a certain way and another expert will offer just the opposite definition.[10]

[7] This definition is taken from LP Love and J B Stulberg, *Understanding Dispute Resolution Processes* (1997).

[8] Indeed, the United Nations Model Law on International Commercial Conciliation defines conciliation as: 'a process whether referred to by the expression conciliation, mediation or an expression of similar import, whereby parties request a third person or persons ("the conciliator") to assist them in their attempt to reach an amicable settlement of their dispute. ... The conciliator does not have the authority to impose upon the parties a solution to the dispute.' UNCITRAL Model Law, Article I, Section (3).

[9] See, eg, J Sekolec & MB Getty, 'The UMA and the UNCITRAL Model Rule: An Emerging Consensus on Mediation and Conciliation' (2003) *J. Dispute Resolution* 175.

[10] Add Rau & Sherman, (2008) 41 *Vand J Transnat'l* L 1251 compared with Lord Wilberforce, Resolving International Commercial Disputes: The Alternatives, in UNCITRAL Arbitration (R&S–mediators evaluate and make recommendations; conciliators merely 'facilitate' Wilberforce: conciliators evaluate and make recommendations; mediators merely facilitate.

However, there is another body of opinion that suggests that conciliation, while sharing virtually all the goals of mediation, is at least structurally – if not philosophically – different from mediation and warrants separate discussion and evaluation. For example, the World Trade Organization defines conciliation as a process that involves neutral persons who conduct independent investigations and suggest resolutions – a process that many ADR specialists would label non-binding arbitration.[11]

In international diplomacy we find a process, often referred to as conciliation, that has been used frequently and with success. In this process, the conciliator does not permit the parties to meet with each other but rather travels back and forth between the parties conveying information and discussion until an agreement is reached. Early on, journalists coined the term 'shuttle diplomacy' for this form of dispute resolution. The distinguished United Nations diplomat, Dr. Ralph Bunche, used this technique in working out a cessation of hostilities between the Arab countries and Israel in 1949.

Yet another process, frequently referred to as conciliation, involves a setting in which Party A hires Conciliator C and Party B hires Conciliator D. Armed by their respective parties with full authority to settle, the two conciliators then negotiate a resolution of the dispute without further involving the parties themselves. In diagrammatic form:

Party A = Conciliator C $\Longleftrightarrow$ Conciliator D = Party B

One can see some benefits to this model. The two conciliators, while not necessarily 'neutral' as that term is used in other dispute resolution settings, are at least separate from A and B and thus, arguably, are more dispassionate and objective. It may be that the two conciliators are expert negotiators where Party A and Party B are not – leading perhaps to a more efficient and more rational solution. But this model might better be described as 'negotiation by agent'. The agents *resolve* the problem, rather than merely assisting the disputing parties as would a mediator.

There are surely other techniques and other models, but getting too bogged down in the problem of definition obscures the basic point of this article – that mediation, properly conceived and properly utilized, is a highly effective way to resolve international commercial disputes. As we think about a successful international commercial mediation, we should consider the following.

[11] HT Pham, 'Developing Countries and the WTO: The Need for More Mediation in the DSU' (2004) 9 *Harv. Negot. L. Rev.* 331, 366. This approach is also similar to the ADR method known as 'early neutral evaluation'.

III. Structuring Mediation: The Danger of Too Many Rules

The basic structure of a mediation is quite simple: Disputing parties A and B sit quietly with Mediator C and discuss their problem. Mediator C, using various techniques, helps the parties resolve the dispute. In truth, many mediations can be handled at this level of simplicity and, in all likelihood, are probably among the most satisfying alternative dispute resolution (ADR) vehicles. Such proceedings are cheap, confidential, speedy and can often result in a comprehensive resolution of the parties' differences. This scenario probably captures most of the mediations that are mentioned in the Qu'ran and the Bible.

But this does not reflect the modern realities of international commercial dispute resolution. These days, it is highly likely that lawyers will be heavily involved and everyone knows that lawyers like lots and lots of rules.[12] For all their inherent common sense, modern business executives are also frequently quite comfortable with rules (indeed, this is how they run their corporations) even though many of them profess not to be. Should mediation be subject to lengthy, comprehensive rules? The answer is 'no'. Too many rules can get in the way of an efficient, timely, cost-effective resolution.[13]

Even so, there must be *some* structure for the proceeding. Otherwise, all that occurs is chaos. There must at the very least be an agreement: (1) as to when and where the proceeding takes place (2) who is to attend (3) what documents are to be produced, (4) the identity and credentials of the mediator, and perhaps a few other things.

Most mediation systems and most of the recommendations for mediation in the literature permit the parties to fashion their own rules. Persons skilled and experienced in mediation, can probably do just fine on their own. However, for those business executives and lawyers who are new to mediation, a quick look at some of the published rules is instructive. A good place to start is with the United Nations Commission on International Trade Law (UNCITRAL) Model Law on International

[12] The author was once invited to serve as a mediator in a business dispute where the lawyers held the upper hand. As part of the agreement to mediate, the lawyers demanded that the mediator apply rules of evidence, permit pre-mediation 'discovery,' allow direct and cross examination of witnesses and prepare a lengthy memorandum of agreement at the conclusion of the proceeding. The lawyers all affirmed that their respective clients were quite happy with these arrangements. Putting on his law professor hat, the author tried to instruct the lawyers in the differences between mediation, arbitration and litigation. Making very little headway, the author finally decided, respectfully, to decline the honor of that appointment.

[13] See, eg, a very provocative article touching on this issue and many others in terms of lawyers' attitudes toward conflict resolution: JH Goldfien & JK Robbennol, 'What if the Lawyers Have Their Way? An Empirical Assessment of Conflict Strategies and Attitudes Toward Mediation Styles' (2007) 22 *Ohio St. J. on Disp. Resol*. 277.

Commercial Conciliation. At the outset, the parties are told that they can vary any of the UNCITRAL provisions by agreement between themselves.[14] One party is expected to invite the other party to the mediation,[15] and a failure to respond is taken as a rejection of the invitation.[16] One of the indispensable factors in a successful mediation is obtaining the services of a competent mediator. UNCITRAL provides for a single mediator unless the parties agree on more than one and, failing an agreement by the parties themselves, an institution may be called upon to suggest or even appoint a mediator.[17]

The Model Law wisely does not prescribe a rigid format for the mediation proceeding. Either the parties can fashion their own rules, or, in the absence of the parties' agreement, the mediator has the power to conduct the proceeding as he or she sees fit. There are three factors that guide the mediator in determining the process: (1) the circumstances of the case, (2) the wishes of the parties, and (3) the need for a speedy settlement of the dispute.[18] There is, however, one point on which the law is rigid when it comes to delineating the conduct of the mediator. If the mediation fails, the mediator is prohibited from serving as an arbitrator in a subsequent proceeding unless the parties agree otherwise.[19]

During the proceeding, one of the most important factors is the guarantee of confidentiality and non-disclosure. The Model Law provides that the parties are obliged to keep things said and done during the mediation confidential.[20] The concept of confidentiality should actually be split into two different components. First, there is the overall requirement that neither the parties nor the mediator nor any other participant disclose anything that is said or done during the mediation. Second, if the mediator chooses occasionally to caucus with the parties separately (a common occurrence in mediation), the mediator normally assures each party that things said during the caucuses will not be revealed to the other party absent consent by the first party.

The second component of confidentiality relates to proceedings external to the mediation. Most systems of mediation require that things discussed or conceded or memorialized during the mediation are *not* to be used in any subsequent proceeding such as litigation. Preserving confidentiality in this context is a bit trickier because there may be instances in which information is required to be disclosed as a matter of law under legal

[14] Article 3, UNCITRAL Model Law on International Commercial Conciliation.
[15] In keeping with the choice of labels made elsewhere in this article, the terms *mediation* and *mediator* will be used even though the Model Law uses the term *conciliation*.
[16] ibid, Article 4.
[17] ibid, Article 5.
[18] ibid, Article 6.
[19] ibid, Article 12
[20] ibid, Articles 8 and 9.

principles that exist outside the context of the mediation. The Model Law reflects this sensitivity by providing that 'such information may be disclosed or admitted in evidence to the extent required under the law or for the purposes of implementation or enforcement of a settlement agreement'.[21]

The Model Law essentially stops at this point in prescribing further procedures for the mediation. This is a healthy approach. Mediation must be flexible to be successful. Many international commercial disputes are complex, but parties should not let the complexity of the subject matter of the dispute get in the way of fashioning simple procedures for the mediation. Too many rules and too rigid a process make mediation look and feel too much like arbitration or litigation. Each of these three devices has advantages and disadvantages but parties should not confuse one with the other.[22]

IV. Identifying and Training Mediators

Many international business executives are suspicious of mediation because they have probably not encountered very many successful mediations. One reason for this is the confidentiality of the process. Parties and mediators are not permitted to speak to outsiders about the mediation. With very few exceptions, narratives of mediations do not find their way into either the legal and business literature or into the popular press. Unfortunately for those of us who try to promote mediation, this is a dispute resolution process that normally hides its light under a bushel.[23]

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[21] ibid, Article 10. *See also*, SR Cole, 'Secrecy and Transparency in Dispute Resolution: Protecting Confidentiality in Mediation: A Promise Unfulfilled?' (2006) 54 *Kan. L. Rev.* 1419. and P Gill, 'When Confidentiality is not Essential to Mediation and Competing Interests Necessitate Disclosure' (2006) *J. Disp. Resol*. 291.

[22] Litigation is frequently maligned as being expensive and time-consuming. It is, without question. But there is a saying in U.S. administrative law that bears repeating here: 'One person's delay is another person's due process.' The rigid procedures in litigation can have the salutary effect of leveling the playing field and correcting for an imbalance of power between the parties. Arbitration has always been seen as a kind of middle ground between quick mediation and prolonged litigation, but the reader should recall the American Arbitration Association, several years ago, stopped trying to sell arbitration as 'the quicker, cheaper' alternative. In truth, mediation may have similar faults. See, e.g., DR Hensler, 'Suppose It's Not True: Challenging Mediation Ideology' (2002) *J. Disp. Resol*. 81 (Professor Hensler comments that the suppositions that mediation saves courts and litigants time and money have 'failed to materialize.')

[23] For an article bemoaning the lack of empirical data on mediation see JR Coben & PN Thompson, 'Disputing Irony: A Systematic Look at Litigation About Mediation' (2006) 11 *Harv. Negotiation L. Rev*. 43–5.('Although mediation has been institutionalized successfully in courts and other contexts, questions abound regarding its impact and effectiveness. A universal complaint is the lack of relevant empirical data.)

And there are other grounds for viewing mediation with some suspicion and doubt. One of the profound shortcomings of mediation is that there is essentially no meaningful credentialling for mediators, nor are there many truly rigorous training programs for international commercial mediators. Some of this problem should be placed squarely at the feet of the major international arbitral institutions. The institutions have made two mistakes: first, there appears to be a general consensus that if one is an experienced and successful arbitrator, one will assuredly be a good mediator. Nothing could be further from the truth. The skills necessary for a good mediator are profoundly distinct from those found in a good arbitrator.[24] Arbitrators must decide. Mediators may not decide. The inability to force a resolution on the parties is frustrating for those persons who are used to presiding at an evidentiary proceeding and forcing a resolution on the contending parties. While both arbitrators and mediators should be good listeners, mediators much more frequently must cope with psychological and emotional factors – which factors tend to get washed out in the more rigid process of arbitration. The structure and approach of arbitration is essentially a litigation-based adversary model. The fundamental concept underlying mediation is negotiation.[25] Arbitration essentially presumes that negotiation has failed. We could go on and on enumerating important differences.[26]

There is a second dimension. There are precious few opportunities for training international commercial mediators. In the United States, many state bar associations and other not-for-profit groups have rudimentary mediator training programs. One program provides a forty-hour program of instruction. Some law and business schools have programs leading to degrees in alternative dispute resolution, but many of these programs pay scant attention to the actual doing of mediation. The international arbitration institutions now pay lip-service to the benefits of mediation but focus almost all of their time and attention on the core business of supervising arbitrations. International commercial mediation will not succeed until and unless we can build a corps of highly qualified, highly-skilled mediators.

[24] Even though I scoff at some of the loftier pronouncements in much of the mediation literature, I recognize that there is a great need for appreciation and understanding of the mediator's role by both mediators and parties. See, e.g., SE Burns, 'Thinking About Fairness and Achieving Balance in Mediation' (2008) 35 *Fordham Urb. L. J.* 39; M Alberstein, 'Forms of Mediation and Law: Cultures of Dispute Resolution' (2007) 22 *Ohio St. J. on Dispute Resolution* 321; G Friedman & J Himmelstein, 'Resolving Conflict Together: The Understanding-Based Model of Mediation' (2006) *J. Disp. Resol*. 523.

[25] For a fascinating article on preparing for mediation using a negotiation template, see DR Philbin, Jr., 'The One Minute Manager Prepares for Mediation: A Multidisciplinary Approach to Negotiation Preparation' (2008) 13 *Harv. Negotiation L. Rev*. 249.

[26] The author has served as both a mediator and an arbitrator. He often feels somewhat smug when he decides an arbitration and issues an award. He is *always* exhausted when he concludes a mediation. In his experience, mediators work far harder than arbitrators *because* they cannot impose a solution on the parties.

V. Measuring the Effectiveness of Mediation

How do we know when a mediation is successful? There are not many guidelines and the literature is nearly non-existent. We certainly know when a mediation has failed and failures in such things as negotiation and mediation, as Professor Wälde often commented, may be more instructive than successes. There have been some attempts at evaluation. Some of the early mediation literature suggested that outcome may not be as important as whether the participants felt respected and 'empowered' at the end of the mediation.[27] A more recent study asserts that the fundamental touchstone is fairness, but other criteria include: (1) participant satisfaction, (2) effectiveness (a measurement of the results actually achieved), and (3) efficiency (a look at the costs, timeliness, resource allocation, and disruptiveness).[28] But it is clear that at this point in time we do not have many tools for evaluating mediation.

VI. Does Mediation Work Only in Certain Cultures?

It is possible that mediation will have a far greater success rate depending on the individual country or the culture in which it is used. It has always been a commonplace in international ADR discussions that persons from Asia and the Pacific Rim find U.S.-style litigation far too harsh, disruptive and alienating. But if we also accept that Western-style arbitration has many attributes that are similar to litigation and that many Asian participants do quite well in arbitration, the assertion may no longer be true.

One would think that a process as free form as mediation could work almost anywhere in the world in any culture. Mediation has been around for thousands of years and one would think that if it never worked, it would have faded from human consciousness long ago. India had a system of mediation referred to as the Panchayat system that traces back centuries before British rule.[29] A number of years ago, at least one writer found conciliation to be consistent with the teachings of the Shari'a.[30] Most commentators find mediation to be fully consistent with Chinese culture and tradition, including Confucian standards and

[27] B Sheppard, 'Third Party Conflict Intervention: A Procedural Framework' (1984) 6 *Res. in Org. Behav*. 226.
[28] J Bercovitch, 'Mediation Success or Failure: A Search for the Elusive Criteria' (2006) 7 *Cardozo J. Conflict Resol.* 289. One study that looks mainly at eBay's use of the Square Trade mechanism for online dispute resolution is: O Rabinovich-Einy, 'Technology's Impact: The Quest for a New Paradigm for Accountability in Mediation' (2006) 11 *Harv. Negotiation L. Rev.* 253.
[29] A Xavier, 'Mediation: Its Origin and Growth in India' (2006) 27 *Hamline J. Pub. L. & Pol'y* 275.
[30] G Sayen, 'Arbitration, Conciliation, and the Islamic Legal Tradition in Saudi Arabia' (2003) 24 U. *Pa. J. Int'l Econ. L.* 905.

values.[31] In 2002, the European Commission issued a Green Paper that identified mediation (more precisely alternative dispute resolution) as a 'political priority' and gave all the European Union institutions the task of promoting ADR techniques, particularly in the setting of cross-border disputes.[32] In 2004, The European Commission proposed a directive of the European Parliament and the European Council on 'Certain Aspects of Mediation in Civil and Commercial Matters'.[33]

Mediation seems to be growing in influence as a rule of law device for developing countries. There is now talk of the 'globalization' of mediation and other forms of ADR and a general acceptance that mediation is a proper tool for effectuating rule of law concepts.[34] It would appear that there are very few barriers and obstacles to utilizing mediation anywhere in the world at the present time.

VII. Selling Mediation to the International Business Community: Some Concluding Thoughts

A neophyte might think, reading everything set out above, that mediation would be a relatively easy sell as we move into the second decade of the twenty-first century. But difficulties remain. One problem is not so much the cost of the mediation itself, but the prospect (that frequently sours the author's clients on mediation) that if the mediation fails, another form of dispute resolution – likely either arbitration or litigation – will have to be used, with all the additional costs that those techniques incur. A lawyer can never promise a client that a mediation will be a success. However, that same lawyer can inform the client that if the client uses arbitration, the arbitrator will decide the case and that the award issued in the case is likely to be final. Many business executives simply opt for the path of least resistance and go straight to arbitration. This issue may reflect the fact that many lawyers are not sufficiently informed on mediation to be able to offer a good, considered judgment on the probability of success of mediation.

There are other problems. There is an unfortunate cultural perception – frequently observed among U.S. lawyers and business executives, but

[31] W Wenying, 'The Role of Conciliation in Resolving Disputes: A P.R.C. Perspective' (2005) 20 *Ohio St. J. on Disp. Resol.* 421. The author comments that 'at present, conciliation plays an important role in resolving disputes arising from almost all areas of Chinese society'.

[32] European Commission, Green Paper on Alternative Dispute Resolution in Civil and Commercial Law (April 19, 2002).

[33] Proposal issued on October 22, 2004.

[34] See, eg, AJ Cohen, 'Debating the Globalization of U.S. Mediation: Politics, Power, and Practice in Nepal' (2006) 11 *Harv. Negotiation L. Rev.* 295; A Crampton, 'Addressing Questions of Culture and Power in the Globalization of ADR: Lessons from African Mediation on American Mediation' (2006) 27 *Hamline J. Pub. L. & Pol'y* 229.

also heard in other places in the world – that mediation is for 'wimps' – that real men (red meat eaters, as it were) shouldn't have anything to do with it. It may now be time for some business executives who continue to eat red meat but who have also experienced successful commercial mediations to speak up on this notion.

In the international business community there are rumors, many but not all unfounded, that the assertions of confidentiality in mediation are not always honored. Secrecy, particularly in matters involving intellectual property, is paramount. As a consequence, we desperately need more research, analysis and writing demonstrating that trade secrets and other important information can be protected in mediation.

There is also the problem of how one goes about enforcing a mediated agreement. In many circumstances, the mediation results in a written agreement that can be enforced under the same doctrines that permit the enforcement of other settlement agreements. In the United States, for example, written settlement agreements are almost always recognized and upheld by the courts. At the international level, some recent literature suggests that the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards might possibly be used as a juridical basis for enforcing international commercial agreements that are the outcome of a mediated settlement.[35]

These are, of course, impediments to a wider use of mediation. But all of these problems and issues can be overcome, hopefully before the twenty-first century ends. At least for some of us, all we ask is: 'give mediation a chance'. You might really like it.

[35] See, e.g., BL Steele, 'Enforcing International Commercial Mediation Agreements as Arbitral Awards under the New York Convention' (2007) 54 *UCLA L. Rev.* 1385.

Going to Pieces without Falling Apart: Wälde's Defence of 'Specialisation' in the Interpretation of Investment Treaties

John P. Gaffney*[1]

I. Introduction

The emergence of specialised and autonomous rules, legal institutions and spheres of legal practice has been described as resulting in the 'fragmentation' of international law.[2] The International Law Commission (ILC) has addressed this issue in a comprehensive report,[3] which offers, in the words of one of its authors 'a theoretical construct and a set of practical techniques aimed at harmonising the disparate parts of international law'.[4] A key aspect of the ILC report was the role of Article 31(3)(c) of the Vienna Convention on the Law of Treaties,[5] as the expression of the principle of 'systemic integration' in treaty interpretation,[6] that is to say, a process whereby international obligations are interpreted by reference to their normative environment. This use of Article 31(3)(c) has been described as providing a framework

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[1] It is with sadness and a sense of privilege that I offer my contribution to this Festschrift/Liber Amicorum for Thomas Wälde. I wish to acknowledge that the first part of the title to this contribution is borrowed from the well-known book of the same name (Mark Epstein, *Going to Pieces Without Falling Apart* (Broadway, 1999)). Not only is the conceit apposite to the subject matter of this contribution, but it also seemed apt to borrow wording from a seemingly unrelated source to reflect Thomas Wälde's wide and eclectic reading habits and his wonderfully lateral thought processes which so often illuminated his writings and OGEMID postings.

[2] See eg, Teubner & Fischer–Lescano, 'Regime-Collisions: The Vain Search for Legal Unity in the Fragmentation of Global Law' (2004) 25 *Mich J Int'l L* 999 (such fragmentation being a reflection of the fragmentation of global society itself); and McLachlan, 'The Principle of Systematic Integration and Art 31(3)(c) of the Vienna Convention' (2005) 54 *ICLQ* 279 ('McLachlan – Fragmentation').

[3] International Law Commission 'Fragmentation' of International Law: Difficulties arising from the Diversification and Expansion of International Law, Report of the Study Group, of the International Law Commission' UN Doc A/CN. 4/L682, 13 April 2006 ('ILC Fragmentation Report'); UN Doc A/CN. 4/L 702, 18 July 2006 ('ILC Fragmentation Conclusions').

[4] McLachlan 'Investment Treaties and General International Law' *ICLQ* 57 ('McLachlan – Investment Treaties') 361, at 364.

[5] Vienna Convention on the Law of Treaties, 1155 U.N.T.S. 331, 8 I.L.M. 679.

[6] ILC Fragmentation Conclusions, para 17: ILC Fragmentation Report, paras 410–423.

of legal reasoning which may be applied to the particular context of investment law.[7]

In a draft of his thoughtful and comprehensive contribution to a *Festschrift* for Professor Christoph Schreuer,[8] which he kindly shared with me, Thomas Wälde posited that concerns about the fragmentation of international law and the proposed reliance on Article 31(3)(c) of Vienna Convention as a principle of 'systemic integration' rested on the idea that 'fragmentation' of international law is 'bad' and needs to be replaced with greater harmony. In his view, it depended on how 'fragmentation' is viewed – if one were to replace the term 'fragmentation' with the term 'specialisation', as a reflection of the increasing specialisation, and the related autonomisation,[9] of parts of global society with all its attendant benefits, it would no longer be imperative to harmonise the different areas into which international law has branched out. Thomas took the opportunity in his draft contribution to outline his initial thoughts on how Article 31(3)(c), viewed through this prism of 'specialisation', might perform a role in the interpretation of investment treaties, having due regard to their place within the wider international legal system.[10]

Prior to his untimely death, Thomas had suggested that I would help him develop these ideas on the role of Article 31(3)(c). Little did either of us realise that this would form the basis of a contribution to his posthumous *Festschrift*.[11] Section II of this contribution outlines in more detail the principles of 'systemic integration' and 'specialisation' as expressions of the interpretative rules contained in Article 31(3)(c) of the Vienna Convention; Section III briefly reviews selected international decisions in which Article 31(3)(c) has featured, including those of investment treaty tribunals; finally, Section IV draws some tentative conclusions and poses further questions for further consideration concerning the role of Article 31(3)(c) in the interpretation of investment treaties.

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[7] McLachlan – Investment Treaties, at 364.

[8] International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer (Ed. Christina Binder and others) (OUP) (2009); Wälde's contribution will be entitled 'Interpreting Investment Treaties: Experiences and Examples' (having originally been entitled at draft stage as 'Interpreting Investment Treaties: Between Confusion and Clarity'). All references to Thomas' theory are taken from the draft version of his contribution (copy on file with author).

[9] ILC Fragmentation Conclusions, para. 5; this phenomenon has lead to concerns that proliferation of particular treaty regimes would not merely lead to narrow specialisation, but to outright conflict between international norms: see McLachlan – Fragmentation, at 280.

[10] Thomas did not believe that the system of investment treaties was hermetically sealed off from the general system of international law.

[11] It is intended that this relatively brief paper will be elaborated for inclusion in a collection of Memorial Volumes dedicated to the memory of Thomas Wälde.

II. 'Systemic Integration' and 'Specialisation' Theories of Interpretation

The legal framework for the interpretation of investment treaties is provided by Articles 31 and 32 of the Vienna Convention. It is generally accepted that these provisions state rules of customary international law on treaty interpretation.[12] They have been accepted by investment treaty tribunals as constituting rules of interpretation which are binding on them in the interpretation of investment treaties, whether by virtue of being directly binding on the parties to the investment treaty, as treaty rules, or as customary international law.[13]

This contribution focuses on the role of Article 31(3)(c), which provides:

> there shall be taken into account, together with the context:
> …
> (c) any relevant rules of international law applicable in the relations between the parties.

As may be seen, there are a number of aspects to Article 31(3)(c). First, it refers to 'rules of international law', and not to broader principles or considerations not firmly established as rules. Secondly, the reference to international law is general such that all sources of international law, including custom, general principles and, where applicable, other treaties, are included. Thirdly, such rules must be both relevant and applicable in relations between the parties (the provision does not specify whether this applies to all parties to the treaty or simply those parties to the dispute). Fourthly, Article 31(3)(c) contains no temporal provisions, that is to say, whether the applicable rules are to be determined as on the date when the treaty was concluded or the date on which the dispute arises.[14]

As Professor Philippe Sands has noted, while Article 31(3)(c) appears straightforward, its actual application in practice, is however difficult to know[15] since it appears to have been expressly relied upon only

[12] Case Concerning the Territorial Dispute (Libyan Arab Jamahiriyav Chad) [1994] ICJ Rep 6; United States – Standards for Reformulated & Convention Gasoline (29 April 1996) (1WT/DS2/ABR).

[13] McLachlan – Investment Treaties; *Saluka Investments BV v Czech Republic*, Partial Award, 17 March 2006.

[14] ILC Fragmentation Report, para. 426; this aspect is not considered in this paper for reasons of space.

[15] Judge Weeramanntry noted that the capacity of Article 31(3) (c) to address relations between treaty and custom and observed that it 'scarcely covers this aspect with the degree of clarity requisite to so important a matter.': Case Concerning the Gacikovo-Nagymaros Project (*Hungary v Czech and Slovak Federal Republic*), 37 I.L.M. 162, at 22 (separate opinion).

very occasionally in judicial practice.[16] He described Article 31(3)(c) as reflecting a principle of 'integration' – emphasising both the 'unity of international law' and the sense in which rules should not be considered in isolation of general international law.[17]

Sands' description of Article 31(3)(c) was later echoed by Professor Campbell McLachlan, who has described it as embodying a principle of 'systemic integration' in treaty interpretation. He states that this principle may be articulated as a presumption with both positive and negative aspects: *positively* in that the parties are taken to refer to general principles of international law for all questions which the treaty does not itself resolve in express terms or in a different way; and *negatively* such that, on entering into treaty obligations, the parties intend not to act inconsistently with generally recognised principles of international law or with previous treaty obligations towards States.[18]

This conceptualisation of Article 31(3)(c) as an expression of a principle 'systemic integration' was also adopted by the ILC. According to the report of the relevant study group, the question of the relationship between the rights and obligation created by treaty and other rights and obligations arising under other treaties or customary international law can only be approached 'through process of reasoning that makes them appear as parts of some coherent and meaningful whole.'[19] Moreover, the

[16] Sands, 'Treaty Custom & Cross–Fertilisation of International Law' (1999) 1 *Yale Human Rights & Development Law Journal* 85 at 86. Sands commented at that stage that Article 31(3)(c) 'attracted very little academic comment' – that has changed quite radically over the past ten years: see eg Hafner, 'Risks Ensuing From Fragmentation of International Law' in Report of the International Law Commission on the Work of its fifty-second Session, 1 May to 9 June and 10 July to 18 August 2000 (A/55/10), 321; Koskenniemi and Leino, 'Fragmentation of International Law? Postmodern Anxieties' (2002) 15:3 *Leiden Journal of International Law* 553; Pauweyln, *Conflict of Norms in Public International Law: How WTO Law Relates to Other Rules of International Law* (Cambridge University Press, 2003); Hafner, 'Pros and Cons Ensuing from Fragmentation of International Law' (2004) 25:4 *Michigan Journal of International Law* 849; McLachlan – Fragmentation, op cit; Simma et al, 'Of planets and the universe: self-contained regimes in international law' (2006) *E.J.I.L.* 483; D French, 'Treaty interpretation and the incorporation of extraneous legal rules' (2006) *ICLQ* 281; Fitzmaurice, 'Canons of Treaty Interpretation: Selected Case Studies from the World Trade organisation and the North American Free Trade Agreement' (2005) 10 *Austrian Review of International and European Law* 41; Klabbers, 'Reluctant Grundnormen: Articles 31 (3) (c) and 42 of the Vienna Convention on the Law of Treaties and the Fragmentation of International Law' in Matthew Craven, Malgosia Fitzmaurice and Maria Vogiatzi (eds), *Time, History and International Law* (Brill: Leiden, 2007) 141; Van Aaken, 'Fragmentation Of International Law: The Case Of International Investment Protection', *Finnish Yearbook of International Law* (2008; U. of St. Gallen Law & Economics Working Paper No. 2008-1 ('Van Aaken')).

[17] Sands op.cit., at 95; Combacau and Sur, *Droit International Public* 177 (2nd Ed.).

[18] McLachlan – Fragmentation at 311 (citing *Georges Pinson (France) v United of Mexican States* [1928] V RIAA 327; and Rights of Passage over Indian Territory (Preliminary Objections) (*Portugal v India*) Case [1957] ICJ Rep 142); see also ILC Fragmentation Conclusions, para 19.

[19] ILC Fragmentation Study, para. 414.

principle of systemic integration goes further than merely restating the applicability of general international law in the operation of treaties, but points to 'a need to take into account the normative environment more widely'.[20] McLachlan adds that 'the significance of [the rules of general international law] is that they perform a systemic or constitutional function in describing the operation of the international legal order, and in establishing a common set of underlying principles which inform it.'[21] In the specific context of investment treaties, he argues that 'there may be particularly compelling reasons to refer to general international law in interpretation' on the basis that investment treaties 'appear more than usually dependent on their wider context'.[22]

Thomas Wälde believed that the proposed use of Article 31(3)(c), advocated by Sands, McLachlan and others, as a tool to 'de-fragment' the various strands of international law, was predicated on a view of the 'fragmentation' of international law as being undesirable and therefore in need of being replaced with 'harmony'. He suggested if one replaces the term 'fragmentation' with the term 'specialisation' it is no longer imperative to feel that the different areas into which international law has branched out need to be harmonised. In addition to the advantages offered by specialisation, such as greater expertise and comparative advantage, specialisation involves different subject matters, different professional and academic communities with their methodology and philosophical preferences. Consequently, 'while everything may be related with everything, it is not an inevitable conclusion that mixing everything together leads in the end to greater order'.

Thomas was particularly concerned that the 'de-fragmentation drive' would lead to importing different international legal orders into international investment law, such as international rules on the environment, human rights and cultural protection. In his view, such a strategy of cross–fertilisation could easily become a system of 'cross–blockage', frustrating the efforts of States, who had chosen to set up specific enforcement procedures in certain specialised branches of

[20] ILC Fragmentation Study, para. 415.

[21] McLachlan – Investment Treaties, at 373. On the issue of 'constitutional interpretation', see also Petersmann, 'Loyola University Chicago International Law Review' (2008) (Draft dated 15 February, 2008: http://www.luc.edu/law/activities/publications/ilrsymposium/2008sym/petersmann_defragmentation_paper.pdf).

[22] McLachlan – Investment Treaties, at 372-374. The ILC posits 3 situations when the use of Article 31(3)(c) would normally arise: (a) if the treaty rule is unclear and the ambiguity appears to be resolved by reference to a developed body of international law; (b) if the terms used in the treaty have a well recognised meaning in customary international law to which the parties can therefore be taken to have intended to refer; (c) if the terms of the treaty are by their nature open-textured in reference to other sources of international law will assist in giving content to the rule. Finally, the necessity to refer to other rules of international law arises only where the treaty itself gives rise to a problem in its interpretation.

international law, by extending the enforcement procedure created for one branch to another branch where it had for quite particular reasons not been chosen before. He maintained that 'implying qualifiers from other areas of international law…risks upsetting the delicate balance, the architecture and design of investment treaties'.[23]

This is not to say that Thomas took an insular view of international investment law (such that developments in other areas of international, and even domestic, law should be ignored). However, he viewed as essential the need to respect the parties' freedom of contract, which he equated with the *lex specialis* nature of a treaty. Consequently, the treaty interpreter ought to begin with a text of the treaty and interpret it 'gradually' in accordance with the rules of the Vienna Convention, rather than start with the presumption that the treaty text more or less paraphrases international law, a temptation to which he believed that some interpreters have succumbed.[24]

He advocated a more cautious application of Article 31(3)(c). First, rules of international law should be relevant and applicable, that is to say rules in other 'cognate' areas, i.e., other investment treaties or comparable instruments, applicable in the relations between the parties. Secondly, such rules should be 'taken into account' rather than be 'applied' to the issues in dispute.[25]

In all of this, I believe that Thomas was influenced by the theory of 'autonomous interpretation'.[26] While this theory is more usually associated with the relationship between uniform law[27] and domestic law, it has been aligned with the principles of interpretation set out in the Vienna Convention.[28] On this theory, the underlying principles on which a treaty is based are referred to as its *internal principles* so far as

[23] For a contrary view, see Van Aacken, supra note 16 (in which it is submitted that 'investment law must evolve and be interpreted consistently with international law, including human rights law, multilateral environmental treaties and WTO law'.)
[24] Wälde cited the separate opinion of Judge Higgins in the *Oil Platforms* case, which is considered infra in Section III of this contribution in support of this view.
[25] Wälde cited *SPP v Egypt*, Decision on Jurisdiction II, 14 April 1988, 3 ICSID Reports 131 and *Compañía del Desarrollo de Santa Elena, S.A. v Costa Rica*, Award, ICSID Case No. ARB/96/1, Final Award, 17 February 2000, in relation to which he observed that the tribunals noted the legitimacy of protecting cultural heritage (SPP) or implementing environmental policies (Santa Elena) but did not allow the fact that such objectives were legitimate and possibly mandated by international obligations of the state to diminish the property protection afforded by investment treaties.
[26] See Gebauer, 'Uniform Law, General Principles and Autonomous Interpretation' 2000-4 *Uniform Law Review* 683.
[27] eg, the Vienna Sales Convention, and the Rome Convention on the Law Applicable to Contractual Obligations.
[28] Roth and Happ 'Interpretation of Uniform Law Instruments According to Principles of International Law' (1997) *Uniform Law Review* 700

they are *connected with and are taken from* the treaty in question, while its *external principles* are by contrast derived from outside the treaty, that is to say, from other uniform instruments where the two Conventions form a coherent body of rules, using the same concepts for similar purposes. An autonomous interpretation of any given treaty provision begins with the literal interpretation of the treaty in question, followed by reference to the treaty's *internal principles*, failing which recourse may be had to *external principles*. Caution should be exercised when attempting to embody external concepts, since they should generally be understood in their own context. For this reason, recourse should be confined to cognate treaties and even then, care should be taken as identical words used in another treaty could turn out to be *faux amis*, conflicting with the aims of the provisions of that treaty if transferred to a different context. Moreover, in the case of the conflict between external and internal principles, the latter are to be preferred because these are based on the system and aims of the uniform law to be interpreted.

Thus, by analogy, the interpretative provisions of Article 31(1)-(3) may be viewed as involving a progression from a literal interpretation of the investment treaty provision in question, through the 'internal principles' of that treaty, and finally to, if necessary, the 'external principles' referenced in, inter alia, Article 31(3)(c).

III Review of International Case Law on Article 31(3)(C)

Until recently, Article 31(3)(c) had been considered, as least expressly, by few international tribunals.[29] For reasons of space, a very selective, brief survey of recent decisions follows.

The decision of the International Court of Justice (ICJ) in the *Oil Platforms* case[30] has been described as a 'bold' application of Article 31(3)(c).[31] The ICJ was called upon to interpret the 1955 Treaty on Amity, Economic Relations and Consular Rights between Iran and United States. The jurisdiction of ICJ was limited to disputes arising as to the interpretation or application of the Treaty. Article XX(1)(d) provided that the treaty did not preclude the application of measures necessary to fulfil the parties' obligations for the maintenance or restoration of international peace and security, necessary to protect its essential security interests. The majority of the ICJ considered that such measures could include the use of armed force and, accordingly, the conditions under which such force could be used under international law applied. Recalling the

[29] See Sands, at 95.
[30] *Islamic Republic of Iran v United States of America* (Merits) Judgement, ICJ Reports 2003, P161.
[31] ILC Fragmentation Report, para. 458.

provisions of Article 31(3)(c), the Courts stated that it could not accept that article XX(1)(d) was intended:

> to operate wholly independently of the relevant rules of international law on the use of force, so as to be capable of being successfully invoked, even in limited context of a claim for breach of the Treaty, in relation to an unlawful use of force. The application of the relevant rules of international law relating to the discretion thus forms an integral part of the task of interpretation entrusted to the Court by ... the 1995 Treaty.[32]

The Court did not give further guidance as to when and how Article 31(3)(c) ought to be applied.

Judge Higgins was critical of the Court's use of Article 31(3)(c). She argued for the need to interpret Article XX(1)(d) in accordance with the *ordinary meaning* of its terms, and in *its context*, as part of an *economic* treaty. She considered that the provision was not one that 'on the face of it envisages incorporating the entire substance of international law on a topic not mentioned in the clause – at least not without more explanation than the Court provides'.[33]

The European Court of Human Rights considered Article 31(3)(c) in a series of three cases in order to decide whether the rules of State immunity might conflict with the rights of access under Article 6 of the Convention. The Courts stated that Article 6 could not be 'interpreted in a vacuum. The Court must be mindful of the Convention's special character as a human rights treaty, and it must also take the relevant rules of international law into account … The Convention should insofar as possible be interpreted in harmony with other rules of international law of which it forms part …'.[34] In each case the Court decided to circumscribe the right of access to Courts by reference to State immunity, which it

[32] *Islamic Republic of Iran v United States of America* (Merits) Judgment ICJ Reports 2003, para 41.

[33] ibid (separate opinion of Judge Higgins), para 46. Sir Franklin Berman QC, a judge ad hoc on the ICJ, has endorsed Judge Higgins' complaint that a 'supposed exercise in treaty interpretation had in fact been used as a device for displacing the applicable law' (see 'Treaty "Interpretation" in a Judicial Context' (2004) 29 *Yale J. Int'l L.* 315, at 320); the US appointed judge on the ICJ, Judge Buergenthal, was even more critical of the Court's approach, advocating a narrow view on Article 31(3)(c): he viewed this as a jurisdictional issue in which the Court's jurisdiction was limited to only those matters which the parties had agreed to entrust to it, and that this also limited extent which Court could refer to other sources of law in interpreting the Treaty. These views contrasted with the position taken by Judge Simma, who advocated a wide use of general international law and other treaty rules applicable to the parties and held that this could be justified under Article 31(3)(c).

[34] *Al-Adsani v United Kingdom* Application No. 35763/97 123 International Law Reports (2001) 24, paras 55–56; See also *Fogarty v United Kingdom* Application No. 37112/97 123 International Law Reports (2001) 54; *McElhinney v Ireland* Application No. 31253/96 123 ILR (2001) 73.

viewed as not imposing a 'disproportionate' restriction on such a right. More recently, in *Andrejeva v. Latvia*,[35] the Court decided it should take the demise of the Soviet Union and Latvia's continuity into account in adjudicating upon the issues in that case. The Court commented that it has never considered the provisions of the Convention as the sole framework of reference for the interpretation of the rights and freedom enshrined therein.

WTO Panels have invoked Article 31(3)(c), largely as a result of the Appellate Body's insistence that they have regard to the wider framework of international law. However, they have evinced a narrower approach than that of the European Court of Human Rights. For instance, in *Argentina – Poultry Anti-Dumping Duties*, Argentina argued that an earlier ruling of a MERCOSUR Tribunal was part of the normative framework to be applied by the panel in accordance with Article 31(3)(c). The Panel disagreed with Argentina and pointed out that Article 3.2 of the Dispute Settlement Understanding was concerned with international rules on treaty *interpretation* rather than treaty *application*. The Panel therefore rejected Argentina's arguments, which it viewed as having the Panel *apply* the relevant WTO provisions in a particular way rather than *interpret* them in a particular way.[36] More recently, in the *Biotech* case,[37] a WTO Panel held that scope of the 'rules of international law' referenced in Article 31(3)(c) ought to be confined to those 'applicable in the relations between WTO Members', that is to say, those rules applicable between *all* parties to the dispute.[38]

There have been relatively few investment treaty cases where Article 31(3)(c) has been considered. In *Kardassopoulos v Georgia*,[39] the Tribunal considered, among other things, the interpretation of Article 45(1) of Energy Charter Treaty (in relation to the provisional application of the Treaty) in light of Article 31(3)(c). The Tribunal was clearly prepared to consider the application of Article 31(3)(c), but concluded that there was some uncertainty whether the provisional application of treaties constitutes a rule of international law applicable in relations between parties to the investment treaty and concluded that the basis for rule of customary international law 'may therefore be lacking'.[40]

[35] *Andrejeva v Latvia* [2009] ECHR 297 (18 February 2009).
[36] WT/DS 241/R (22 April 2003), Para. 7.41-7.42.
[37] European Communities — Measures Affecting the Approval and Marketing of *Biotech Products* (WT/DS 291, 292 and 293).
[38] ibid, paras 7.67-7.68.
[39] ICSID Case No. ARB/05/18, Decision on Jurisdiction, 6 July 2007 (Fortier, Orrego, Watts).
[40] ibid, paras 207-218; however, the Tribunal found sufficient justification for interpreting Article 45(1) as meaning that each signatory was required to apply the whole of the Treaty even before it had formally entered into force and based on reading of the 'clear terms of the Treaty providing for provision application', coupled with such application being consistent with the 'object and purpose of the Treaty' (paras 221-223).

Article 31(3)(c) received detailed consideration in the decision in *RosInvest Co UK Limited v The Russian Federation*,[41] in which the claimant urged the Tribunal to adopt a 'dynamic' approach to interpretation of the investment treaty concluded between the Russian Federation and the United Kingdom. In this regard, the Claimant argued, among other things, that the Tribunal should give full weight, for the purpose of giving meaning to its terms, to the dissolution of the former USSR, the emergence of the Russian Federation as its legal continuation and the radically different economic, trading and investment policies adopted by the Russian Federation.[42] The Tribunal rejected this contention.

Commenting on Article 31(3)(c) the Tribunal noted that the qualification contained in that provision, 'applicable in relations between the parties' must be taken as:

> a reference to the rules of international law that conditioned the performance of the specific rights and obligations stipulated in the Treaty – or else it would amount to a general licence to override the Treaty terms that would be quite incompatible with the general spirit of the Vienna Convention as a whole.[43]

The Tribunal noted that the cases cited by the claimant related in their entirety to human rights treaties and to the constituent instruments of international organisations. It distinguished both of these as '*special*' cases.[44] The Tribunal viewed it as 'difficult to see what bearing any of this might have on the jurisdiction of an arbitral tribunal, which remains, as it always has been, a matter of specific consent by the parties.'[45] The Tribunal continued:

> It is open to serious question, moreover, whether these special kinds of multilateral treaty are at all analogous to bilateral engagements regulating a particular area of the relations between one Party and the other. Here a bargain is a (reciprocal) bargain. The Parties must be held to what they agreed to, but not more, or less.[46]

[41] *RosInvest Co UK Ltd v Russian Federation*, Jurisdiction award, SCC Case No V079/2005, 5 October 2007 (Bockstiegal, Steyn, Berman).
[42] Cf, *Andrejeva v Latvia*, supra.
[43] ibid, para 39. Sir Franklin Berman, who sympathized with the views expressed by Judge Higgins in the Oil Platforms case, supra, was a member of the *RosInvest* Tribunal.
[44] ibid, (holding that the former (human rights) 'because they represent the very archetype of treaty instruments in which the Contracting Parties must have intended that the principles and concepts which they employed should be understood and applied in the light of developing social attitudes….; the latter (international organisations) because it is generally understood, that given the changing nature of the providences and circumstances International Organisations have to confront, a degree of evolutionary adaptation as the only realistic approach to realising the underlying purposes of the organisation as laid down in its constituent instrument').
[45] ibid
[46] ibid, para 40

The Tribunal noted that the apparently 'progressive' approach advocated by the Claimant might have an 'utterly pernicious effect' if it allowed a Respondent State to claim to escape from the guarantees that it had bound itself in earlier bilateral treaties and, accordingly, the Tribunal could see no way 'in which it could devise a legal ratchet under which changes or, circumstances could be admitted in one direction only but not the other'.[47]

The Tribunal concluded that the correct approach was to interpret the BIT objectively, on its terms, under the rules laid down in the Vienna Convention (without any presumption either in favour or against the Tribunal's own jurisdiction).[48] The Tribunal later noted that all the subsections of Articles 31(2) and 31(3) of the Vienna Convention 'require some relation or connection to the treaty to be interpreted' (a requirement not fulfilled by earlier or later investment treaties or other agreements or other practice either of the UK or the Soviet Union or Russia).[49]

IV. Tentative Conclusions and Further Questions

To conclude this contribution, I offer a number of tentative conclusions and pose a number of questions concerning the role of Article 31(3)(c) in the interpretation of investment treaties. There can be little doubt but that Article 31(3)(c) has a role to play in interpretation of treaties; the debate has really moved onto the precise role it ought to play. Some tribunals, for example the European Court of Human Rights, expressly or implicitly view Article 31(3)(c) as means of achieving *systemic integration* whilst other tribunals, notably *ad hoc* tribunals, appear to favour a more restrictive role for reasons very similar to those underpinning Thomas Wälde's advocacy of *specialisation*. Notably, the latter approach manifests itself where the jurisdiction of the particular tribunal rests on the specific consent of the parties in the particular case in contrast to, say, cases arising under the European Convention on Human Rights, where State consent to the Court's jurisdiction is arguably implicit in ratification of the Convention and related protocols.[50] Moreover, such

[47] ibid, para 41.
[48] ibid, para 44.
[49] ibid, para 119. Article 31(3)(c) was more recently considered in *Rompetrol Group v Romania*, ICSID Case No. ARB/06/3, Decision on the Respondent's Plenary Objections on Jurisdiction and Admissibility, 18 April 2008 (Berman, Donovan, Lalonde) and *Micula and Ors v Romania* ICSID Case No. ARB/05/20, Decision on Jurisdiction and Admissibility, 24 September 2008 (Levy, Alexandrov, Ehlermann). Both tribunals were evidently prepared to consider, if necessary, relevant rules of international law in the interpretation of the relevant investment treaties.
[50] One notable exception is the European Court of Justice which fills lacunae by analogies within the system or by recourse to general principles inherent in the EC legal order: see Simma, op.cit. footnote 16, at 504.

systems exhibit a quasi-constitutional structure, in contrast to largely *ad hoc* nature of investment treaties and investment treaty disputes.

The role of Article 31(3)(c) will likely vary according to the scope and type of the treaty to be interpreted. One senses that a clear distinction is being drawn between *human rights treaties*, which are characterised by structural non-reciprocity and collective enforcement of the obligations to which they give rise, and, *economic treaties*, for example, investment treaties, which are characterised by the reciprocity and individual enforcement (by way of State-State or State-investor action) of their obligations. In the context of investment arbitration, such a distinction is likely to militate against the relevancy of human rights and, possibly, environmental protection, treaties for the purpose of applying Article 31(3)(c) in the interpretation of investment treaties.[51]

Considering the relative paucity of investment treaty case law, however, it would be premature, to speculate, as to which of the competing theories considered in this contribution will be favoured by investment treaty tribunals. Indeed, there are clearly a number of significant issues that remain to be addressed regarding the role of Article 31(3)(c) in the interpretation of investment treaties, as follows.

Which rules of international law are 'relevant' for the purpose of interpreting investment treaties? It will be evident that Thomas Wälde was concerned that recourse would be limited to relevant provisions of 'cognate' treaties – is this to occur only where they give rise to a coherent body of rules using the same concepts for similar purposes, or more narrowly, where they condition the performance of the obligations of, or have some relation or connection to, the treaty provisions that are to be interpreted?

How are investment treaty tribunals to construe the requirement of Article 31(3)(c) that relevant rules of international law 'shall be taken into account'? Does this mean that investment treaty tribunals are simply called to be mindful of such rules in interpreting the relevant treaty provisions or are they actually required to apply relevant rules of general international law in specific investment treaty cases? Thomas seemed to favour the former, more cautious approach, which perhaps he viewed as a pragmatic compromise between the ideal of a unified

[51] Of course, some investment treaties might expressly include provisions for example, for potential environmental obligations of a state as a reasonable purpose for the national measure in question. The US Model BIT of 2004 states in its Annex B on expropriation that: 'Except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.' (See Van Aaken op cit, at 17).

system of international law and the particularistic reality of the *lex specialis* nature of investment treaties and the concomitant freedom of the contracting State parties to shape new rules in relations between them concerning investment matters.

At which stage of the adjudicative process should the interpretative role of Article 31(3)(c) apply? Ought it to apply in the determination by the tribunal of its jurisdiction? Or ought it precede or apply at a later stage in the application of the treaty provisions?[52]

When applying Article 31(3)(c) should Tribunals possibly circumscribe or indeed partially disapply the investment treaty provision i.e., the negative effect of Article 31(3)(c) described by McLachlan? I can't imagine that Thomas favoured such a use of this provision; as one commentator has noted:

> the purpose of interpreting by reference to 'relevant rules' is, normally, not to defer the provisions being interpreted to the scope and effect of those 'relevant rules', but to clarify the content of the former by referring to the latter.[53]

What role should jus cogens play in this process? Does it apply in determining the question of the tribunal jurisdiction or does it come into play when the application of the treaty provision is considered by the tribunal?

Finally, ought Article 31(3) (c) form part of a 'holistic' application of Article 31 to the interpretation of a treaty provision, or ought it apply only where the earlier sub–articles of Article 31 do not ascribe meaning to an ambiguous treaty provision? In other words, does Article 31(3)(c) only come into play if the meaning of the relevant investment treaty provision is not clear and one applies the 'ordinary meaning' under Article 31(1) or in relation to issues of context (Article 31(2))? Thomas seemed to prefer the former approach, that is to say, a progression from internal to external principles in the interpretation of investment treaties.

In endeavouring to formulate answers to these and other questions concerning the proper application of Article 31(3)(c) to the interpretation

[52] One commentator observes: '[i]n practice … there is a good chance that the two (application and interpretation) might lapse into each other – such would seem well-nigh inevitable, if only because it would be difficult to apply something without at the same time interpreting it, and to interpret a term without a context in which to apply it.' (Klabbers, supra note 16, at 144).

[53] Orakhelashvili, 'Restrictive Interpretation of Human Rights Treaties in the Recent Jurisprudence of the European Court of Human Rights' (2003) 14 *E.J.I.L.* 537.

of investment treaties, we can only hope to emulate Thomas in his creative thinking, rigorous analysis, and colourful articulation. If there is a guiding vision, which ought to inform research in this area, I believe it may be that Thomas favoured a vision of the international legal system – of which international investment treaties form part – as a rich mosaic. I suspect he was concerned that attempts to harmonise these fragmented elements would recompose the system in a banal monochrome. To those who knew Thomas, this will hardly come as a surprise.

Investment Treaties and Domestic Courts : A Transnational Mosaic Reviving Thomas Wälde's Legacy

Walid Ben Hamida*

I. Introduction

Professor Wälde always maintained a thoroughly open attitude towards the outside world, largely due to his grasp of languages (English, German, French and Spanish), his extensive general knowledge, and his curiosity to know, learn, and understand. He contributed to the exploration and to the explanation of domestic and international case law and played a pioneering role in globalising investment law. To honor the memory of this exceptional man and recognized specialist of international investment law, I will examine the investment treaties that have come before domestic courts, an issue that encourages cross-border dialogue, cross-cultural exchanges and cross-disciplinary fertilisation, all values that Professor Wälde contributed to promote.[1] This work benefited from online discussions on the OGEMID, a virtual and genuine community built by Professor Wälde to enhance the exchange of views and experiences between cultures.

There is an important literature on the interpretation of investment treaties by arbitral tribunals constituted under BITs and MITs. However, little has been said on the interpretation of these agreements by domestic courts. There are two reasons for the focus on arbitral jurisprudence. First, investment treaties are mainly invoked before international arbitral tribunals and not before national courts. Interstate and domestic courts proceedings have been virtually replaced by '*l'arbitrage unilateral transnational*' – direct investor-state arbitration.[2] Second, ICSID arbitration, the most frequent arbitral system used by investors under

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[1] T Wälde, 'Why a Transnational Dispute Management Intelligence Service?' http://www.transnational-dispute-management.com/about/welcome.html.

[2] T Wälde, 'The Special Nature of Investment Arbitration' in *New Aspects of International Investment Law/Les aspects nouveaux du droit des investissements internationaux* (Edited by Ph Kahn and T Wälde, 2004) 92.

investment treaties, is self-contained and insulated from interference by domestic courts. The ICSID Convention precludes appeals to domestic courts in the seat of the arbitration and provides for an internal ICSID Annulment Committee to review the arbitral awards.

However, domestic courts can play an important role with respect to investment agreements. There is an emergent jurisprudence on the interpretation of BITs and MITs emanating from national judges. Indeed, domestic courts can review the constitutionality of investment treaties (I). They may directly redress breaches of these treaties (II). Finally, even when foreign investors opt for international arbitration, domestic courts can play a significant role in the interpretation and application of an investment agreement's provisions (III).

II. Domestic Court Intervention to Review the Constitutionality of Investment Treaties

Domestic Courts may review the constitutionality of investment treaties or laws approving them. This review power may be entrusted to a special constitutional court or to the ordinary courts. Decisions on the constitutionality of investment treaties are rendered in Canada and Colombia.

In Canada, there are at least two constitutional challenges of the NAFTA investment chapter. On March 2001, the Council of Canadians, the Canadian Union of Postal Workers and the Charter Committee on Poverty Issues filed a notice of application in the Ontario Superior Court of Justice alleging that the dispute settlement provisions of Chapter 11 violate the Canadian Charter of Rights and Freedoms as well the Constitution Act. The Claimants asserted that NAFTA Chapter 11 deprives Canadian courts of the authority to adjudicate claims against the State by private parties, matters reserved to them by the Constitution. They also argued that this chapter infringes and denies the rights and freedoms guaranteed by the Charter of Rights and Freedoms and the Canadian Bill of Rights, including those concerning fundamental justice, fairness and equality.[3] Justice Pepall of the Ontario Superior Court dismissed the application. She recognized that NAFTA investor-state arbitration 'lacks predictability', 'lacks total transparency' and '[t]here is no consistent mechanism for review of the decisions [rendered by NAFTA] tribunals'. Nevertheless, she dismissed these concerns, pointing out that 'a treaty is a bargain', and that her task is 'not to

[3] *Council of Canadians, CUPW and the Charter Committee on Poverty Issues v the Attorney General of Canada,* Ontario Superior Court of Appeal, Reasons for Judgement, July 8, 2005 available at http://www.international.gc.ca/trade-agreements-accords-commerciaux/disp-diff/cupw.aspx?lang=en.

remedy unpopular provisions', but to determine whether Chapter 11 is in violation of Canada's Constitution. The Court of Appeal of Ontario confirmed this decision.[4] In addition to this first constitutional challenge, on May 2001, Democracy Watch and the Canadian Union of Public Employees filed a notice of application in the Ontario Superior Court of Justice seeking to declare NAFTA Chapter 11 unconstitutional and inconsistent with the Canadian Charter of Rights and Freedoms. Hearing dates have not been set in this case.[5]

In Colombia, the Constitutional Court must first review all treaties, including investment treaties, approved by the Congress before their signature by the President. During the constitutional review process, any citizen and public authority has the right to intervene. The Colombia Constitutional Court has rendered many decisions on the constitutionality of Colombian BITs.[6] The only provision that has raised constitutionality problems is the expropriation clause provided in many Colombian BITs. Since 1996, the Court has considered this provision inconsistent with two articles of the Colombian Constitution. First, the expropriation provision, by requiring the payment of compensation before any expropriation, violates Article 58 that authorises the Parliament, by vote of an absolute majority, to decide not to pay such compensation for reasons of equity. Second, the expropriation clause is inconsistent with Article 12 of the Constitution that requires an equality of treatment between Colombians and Foreigners since the absolute right to compensation benefits only foreign investors.[7] It is interesting to observe that the Constitutional Court found that other BIT provisions, including the state-investor arbitration clause, are consistent with the Constitution. The Court held that due to the particular nature of investment disputes and given the fact that the BIT obliges investors to turn to domestic courts before seeking arbitration in respect to administrative acts, as required by Colombian law, it is more appropriate to submit investment disputes to an investor-state arbitration mechanism.[8]

[4] Court of Appeal for Ontario, Reasons for Judgment, November 30, 2006, available at http://www.international.gc.ca/trade-agreements-accords-commerciaux/disp-diff/cupw.aspx?lang=en.

[5] See *Democracy Watch and CUPE v the Attorney General of Canada*, available at http://www.international.gc.ca/trade-agreements-accords-commerciaux/disp-diff/cupe.aspx?lang=en

[6] Decisions of The Constitutional Court are available at http://www.secretariasenado.govco/senado/basedoc/arbol/4623.html. See, for example, C-379 de 1996 (BIT Colombia-Cuba), C-961 de 2003 and C-008 de 1997 (BIT Colombia-Peru), C-294 de 2002 (BIT Colombia-Chile) and C-750/08 (US-Colombia Free Trade Agreement that contains an investment chapter).

[7] See on expropriation, Sentencia C-358/96 dealing with the UK-Colombia BIT, Decision of August 14, 1996 and Sentencia C-494/98 regarding the Colombia-Spain BIT.

[8] In addition to Canada and Colombia, there is a debate on the constitutionality of investment treaties in Bolivia. However, application challenging the constitutionality of Bolivia BITs was dismissed by the Constitutional Court on the ground that the constitutionality of treaties can only be subject to an *ex ante* review, before approval. See *Wilson Beimar Magne*

Cont.

III. Domestic Court Intervention to Redress Breaches of Investment Treaties

Domestic courts can review the respect by the State of its obligations under investment agreements. In many investment agreements, investors have an option to bring a claim to a domestic court or to an arbitral tribunal. Other treaties give domestic courts the initial opportunity to remedy to any injustice committed against the foreign investor before requesting international arbitration. Recourse to domestic courts to redress state failures to respect obligations provided in investment treaties may raise the problem of the self-executing/ *Effect direct* character of such treaties and their enforceability in domestic proceedings.

It could be asserted that investment treaties contain imprecise notions and vague rules, such as 'fair and equitable treatment', 'protection and security', 'expropriation', that are 'non-self-executing' and cannot give rise to domestically enforceable rights.

When facing a tax claim before the French Cour de Cassation, the highest court in the French judiciary, the French Tax Administration adopted this position. The *Directeur general des impôts* asserted that the Panama-France BIT of November 5, 1982, which provides in its Article 8 for an investor-State arbitration under UNCITRAL rules, did not contain a substantial provisions directly applicable to nationals and companies and does not entitle them a direct right of action before the courts'.[9] Unfortunately, the Cour de cassation did not examine this issue. However, the *Conseil d'Etat*, the French higher administrative jurisdiction, in a recent decision, held that Article 3 of the Algeria-France BIT of 1993 relating to fair and equitable treatment and prohibition of unreasonable and discriminatory measures has only an inter-state effect and cannot cover a private person contesting the rejection of his visa request.[10] The Decision of the *Conseil d'Etat* is striking because Article 8 of the same treaty provides that all disputes

Hinojosa, Diputado Nacional contra Eduardo Rodríguez Veltzé, Presidente Constitucional de la República de Bolivia, y otro, Sentencia TC 0031/2006, 10 May 2006, available at http://www.tribunalconstitucional.govbo/expediente13011.html on this case A Newcombe, L Paradell, *Law and Practice of Investment Treaties. Standards of Treatment* (Wolters Kluwer, 2009) 51. Recently, some Philippine NGOs lodged a petition before the Philippine Supreme Court arguing that the investment chapter of the Japan-Philippines Economic Partnership Agreement violates the Philippine Constitution. Mainly, they asserted that this chapter violates constitutional limits on foreign ownership in some sectors like real estate, mass media, advertising, and public utilities.

[9] Cour de Cassation, Chambre Commerciale, Decision of October 17, 1995, available at http://www.legifrance.gouvfr/.

[10] Conseil d'État, N°280264, Decision of December 21, 2007, available at http://www.legifrance.gouvfr/.

arising out of the BIT can be submitted either to the domestic court of a Contracting Party or to ICSID.[11]

Similarly, the Supreme Court of Pakistan, in the *SGS* case,[12] held that neither the Swiss-Pakistan BIT of 1994 nor the ICSID Convention had been incorporated into Pakistani law by legislation and, therefore, these two agreements could not relied upon to confer rights on individuals.

It is also interesting to observe that US and Canada consider NAFTA as a non-self-executing treaty. In the USA, Section 102 of the NAFTA implementation act precludes any direct effect of NAFTA. In Canada, Section 6 of North American Free Trade Agreement Implementation Act prohibits any private cause of action under NAFTA.[13]

However, the assertion that investment treaties are not self-executing treaties could be challenged. It was suggested that the fact that the US legislature found it necessary in the NAFTA implementing legislation to include a clause preventing direct effect and private action before the US Courts indicates that NAFTA would otherwise likely be self-executing.[14] Therefore, in the absence of such preventing clause, investment agreements are surely *self-executing*. Furthermore, many authors[15] and national judges consider BIT provisions as '*self-executing* agreements'.

In *Desarrollos en Salud*,[16] an Argentina court held that the Argentina-Belgo-Luxembourg BIT has primacy over domestic legislation and

[11] See, however, two decisions rendered by the *Cour Administrative of Paris*, a lower court, in two tax disputes, related to the France-Zaïre BIT of 1972. In the first decision (N° 08PA00107, October 8, 2008), the Court discussed the applicability of Article 7 (non-discrimination in tax matters), Article 8 (preservation of favourable rights clause) and Article 10 (investor-state dispute settlement clause). In the second decision (N° 96PA00972, November 10, 1998), the Court held that the claimant did not demonstrate that he has a protected investment under the BIT to take benefit of it. These two decisions my show that this Court admits implicitly the direct effect character of this BIT provisions. The two decisions are available at http://www.legifrance.gouvfr/

[12] Supreme Court of Pakistan (Appellate Jurisdiction), *Société Générale de Surveillance S.A. v Pakistan*, July 3, 2002, § 18-28, *International Law Reports*, Volume 129, p. 323. The Court also decided that SGS didn't make a protected investment within the meaning of the BIT.

[13] Section 6 of North American Free Trade Agreement Implementation Act (993, c. 44), available at http://laws.justice.gc.ca/en/showdoc/cs/N-23.8/bo-ga:s_4::bo-ga:s_5?page=3.

[14] A de Mestral and J Winte, 'Giving Direct effect to NAFTA. Analysis of issues' in TJ Courchene, DJ Savoie, D Schwanen (eds) *The Art of the State II: Thinking North America* (second edition, IRPP, 2008) 344.

[15] See on the *self-executing* character of BITs, CD Wallace, *The Multinational Enterprise and Legal Control: Host state Sovereignty in an Era of Economic Globalization* (Martinus Nijhoff Publishers, 2002) 364; W Sachs, 'The New U.S. Bilateral Investment Treaties' (1984) *Int. Tax and Bus. Law*, 197 and the references quoted.

[16] *S.A S/Concurso preventivo/ S/ Incidente de Revisión* (N.V NISSHO IWAI S.A. (BENELUX), Juzgado Comercial 26, Secretaría 51, 10 Nov 2003, available at http://fallos.diprargentina. *Cont.*

could be invoked by a Belgium corporation to contest the conversion of its private contract from US dollars to Argentina pesos. The Court interpreted the notion of investor and the notion of investment and applied the non-expropriation provision. In the *IGJ* case, another Argentina court interpreted the notion of investment and the free transfer provision under the Spain-Argentina BIT.[17]

A similar approach can be found in Venezuela. In *Aerolíneas Argentinas*, an Argentina company complained of a change of currency laws, and sued the Republic of Venezuela and the Central Bank of Venezuela. The Claimant invoked the MFN clause provided in the 1993 Argentina-Venezuela BIT to claim coverage under provisions from other treaties signed by Venezuela. The Political and Administrative Chamber of the Supreme Tribunal of Justice did not find any obstacle to the applicability of this BIT provision.[18] In another decision, the Constitutional Chamber of the Supreme Tribunal of Justice applied the Netherlands-Venezuela BIT and interpreted the notion of investor and the concept of control contained in this treaty.[19]

Recently, in *Kessl v Minister of Lands and Resettlement et. al*, the High Court of Nambia did not hesitate to refer to the Germany-Namibia-BIT to settle an expropriation dispute between three German nationals and Nambia. The investors challenged the expropriation of their land and asserted that the way in which the expropriation was carried out breached the Namibian Constitution, the land reform law and constituted discrimination prohibited by the Germany-Namibia BIT, given that it focused specifically on farms belonging to foreign nationals. In its decision of March 6, 2008, the High Court ruled in favour of the claimants. Although the Court's decision was based on national law, it did rule that the BIT must be respected. It pointed out that: 'As German citizens, the three applicants are entitled to the same treatment as Namibian citizens in terms of the Encouragement and Reciprocal Protection of Investments Treaty which was entered into by the Republic of Namibia and the Government of the Federal Republic of Germany'.[20] In the same vein, some decisions of the Mexican Supreme Court have referred to the

com/2007/09/desarrollos-en-salud-s-concurso-s.html On this decision, see the comment of A Newcombe, L Paradell, supra, pp. 100-101.

[17] *Inspección General de Justicia v Empresa Naviera Petrolera Atlántica S.A*, Decision of Mai 17, 2007, available at http://fallos.diprargentina.com/2007/09/igj-c-empresa-naviera-petrolera.html.

[18] Decision No. 00736 of May 20, 2003, available at http://www.tsj.govve/decisiones/spa/Junio/01391-150600-15531.htm.

[19] Decision No. 903 of May 14th, 2004, available at http://www.tsj.govve/decisiones/scon/Mayo/903-140504-03-0796%20.htm.

[20] § 107, Decision of 6 March 2008, available at http://www.nepru.org.na/index.php?id=322&no_cache=1&file=1241&uid=598. The Namibian government has since appealed the decision before the Supreme Court.

non-discrimination rule provided in an investment treaty (NAFTA) to confirm a solution handed down based on the Constitution.[21]

Another argument in support of the *self-executing* nature of investment agreements is the analogy between these treaties and Treaties of Friendship, Commerce and Navigation ('FCN'). The FCN treaties that preceded their modern counterparts, BITs and MITs, are considered as *self-executing* by the American[22] and Italian courts.[23] Furthermore, BITs and MITs make reference to foreign investors' ability to enforce BIT rights through the domestic courts. This reference is an important element in showing that the treaty creates a private right of action. On 26 August 2008, the US Court of Appeals for the DC Circuit handed down an important decision relating to the applicability of an expropriation provision in the Treaty of Amity, Economic Relations and Consular Rights between the US and Iran in domestic legal proceedings[24]. In this case, a US company claimed that Iran had expropriated its property without paying compensation, which is incompatible with article IV of the treaty. The Court maintained that the Treaty of Amity was 'self-executing' in the US. However, it cannot create a cause of action before the US courts for a US company. The Court stated that according to US case law, there was a presumption that 'international agreements, even those directly benefiting private persons, generally do not create private rights or provide for a private cause of action in domestic courts'. Pointing out that the Treaty does not refer to the dispute resolution methods that would enable nationals from the two countries to ensure that conventional obligations are fulfilled, the Court of Appeal held that violations of these treaties must be addressed by direct negotiation between the States that signed them.[25]

[21] *Maria Teresita Machado et al*. AR 1132/2004, S.C.J.N. (pleno) and *Fomento Azucarero Mexicano et. al,* AR 1132/2004, S.C.J.N, available at http://www.scjn.gob.mx/NR/rdonlyres/16792E0B-1A37-46EA-8285-1EB9723E8EE5/0/AR_11322004.pdf, See on these decisions S Puig and M Motañez, 'Investment Arbitration: Substitute or Complement for Domestic Institutions? The NAFTA Waiver and the Recent Mexican Experience', forthcoming.

[22] *Spiess v Itoh, 643 F.2d 353 (5th Cir. 04/24/1981), Asakura v City of Seattle, 265 US 332 (1924)*. On the effect of FCN, see William S. Dodge, Investor-State Dispute Settlement Between Developed Countries: Reflections on the Australia-U.S. Free Trade Agreement, 39 *Vand. J. Transnat'l L*. 1, 19-20 (2006), available at http://w3.uchastings.edu/dodge_01/AUSFTA.pdf, Boleslaw Adam Boczek, *International Law: a Dictionary* (Scarecrow Press, 2005) 14.

[23] In *Elettronica Sicula S.p.A. (ELSI) (United States of America v Italy),* the Italian Government observed that Provisions of the FCN treaty between US and Italy had been regarded by the Italian Court of Cassation as *self-executing.* See, for example, Decision No. 2228 of 30 July 1960, *The Durst Munufacruring Co. v Banca Commerciale Italiana*, with reference to Article V, paragraph 4,of the Treaty 64 *Rivista di Dirttro Inlernazionile* (1961), pp. 17-118, see also Counter-Memorial of Italy, 16 November 1987, p. 28-29.

[24] *McKesson v Iran*, available at http://pacer.cadc.uscourts.gov/docs/common/opinions/200808/07-7113-1135046.pdf.

[25] It is important to mention that Irish Court deny any self-executing character to FCN. See, *Blascaod Mor Teoranta v Commissioners of Public Works in Ireland [1998] IEHC 38 (27 February, 1998)* about a dispute relating to a compulsory acquisition of property before the High Court, available http://www.bailii.org/ie/cases/IEHC/1998/38.html §. 127

IV. Domestic Court Intervention to Support Investment Arbitration

Even when foreign investors opt for international arbitration, domestic courts can play a significant role.

In few cases, domestic courts have been asked to prevent the investor from commencing or continuing an arbitral proceeding under an investment treaty. Usually, the tool used to achieve this goal is the *anti-suit injunction*, an order issued by a domestic court to the investor or the arbitral tribunal to stop the proceedings. In *SGS v Pakistan*, the Supreme Court of Pakistan issued an anti-suit injunction against SGS restraining it from taking any action to pursue its BIT arbitration.[26]

However, in the majority of cases, domestic courts have supported Investor-State arbitration. Investment arbitration, in particular non-ICSID arbitration, i.e under UNCITRAL, SCC, ICC, and ICSID additional facility rules, needs the support of domestic courts and these courts may interpret and apply investment agreements. Domestic courts can issue decisions relating to arbitrators' challenges (1). They are sometimes requested to grant provisional measures (2). They have jurisdiction to set aside an arbitral award rendered by non-ICSID BIT/MIT tribunal (3). Finally, they can intervene to enforce arbitral awards (4).

A. Challenge and Disqualification of Arbitrators

Domestic courts can examine claims relating to challenge and disqualification of arbitrators set up under investment treaties. Two cases have illustrated this function. In *Republic of Ghana v Telekom Malaysia Berhard*,[27] submitted under the Ghana Malaysia BIT, the District Court of The Hague - the seat of the arbitration - found that there was a conflict of interest between the position of an arbitrator in the Ghana case and the position of an advocate seeking the annulment of an award in another BIT case before ICSID. In *Poland v Eureko*,[28] the Court of First Instance in Brussels rejected a request to disqualify an arbitrator from an arbitral tribunal constituted in Brussels under the Netherlands-Poland BIT. The Brussels Court of Appeals confirmed this judgement.[29]

[26] The ICSID Tribunal however in its Decision on Jurisdiction rendered on 6th August 2003, in ICSID Case No. ARB/01/13, disregarded the decision of the Pakistani Supreme Court.

[27] *Republic of Ghana v Telekom Malaysia Berhard*, District Court of The Hague, 18 October 2004, Challenge No. 13/2004; Petition No. HA/RK 2004.667; and Challenge 17/2004, Petition No. HA/RK/2004/778, November 5, 2004, available at *TDM*, Vol. 2 - issue 1 January 2005.

[28] Judgment of Court of First Instance of Brussels on challenge to arbitrator, 22 December 2006. available at http://ita.law.uvic.ca/

[29] Brussels Court of Appeal, Decision of October 29, 2007, R.G. 2007/AR/70, *Petites affiches*, Mars 2008, p. 15, available at http://www.master-arbitrage.uvsq.fr/revue/vol2-2008/ChroniqueLPA200803.pdf

B. Requests for Provisional Measures

There are many decisions illustrating domestic court intervention to grant provisional measures in relation to an investment arbitration proceeding. Domestic courts may assume this function even when the investor has decided to submit the claim to ICSID arbitration. ICSID rules allow parties to seek provisional measures from national courts if authorized by the applicable investment treaty.[30]

In *Romak v Uzbekistan*,[31] the Court of Appeal of Paris rendered a decision to secure the execution of an arbitral award submitted under a BIT. Romak, a Swiss company, had sold wheat to Uzdon, an Uzbek public company. As this company failed to pay the price, Romak sued it before an arbitral tribunal as provided in the wheat agreement, and obtained a GAFTA award ordering Uzdon to pay. The courts of Uzbekistan refused to enforce the award. Romak invoked the UNCITRAL arbitration provisions in the Switzerland-Uzbekistan BIT. To guarantee that there would be funds available to pay any BIT award that might eventually be rendered against Uzbekistan, Romak obtained an order to freeze a bank account in France opened in the name of Uzbekistan Airways. On October 26, 2007, the *Juge de l'exécution*[32] upheld this freezing order.[33] On appeal, the State of Uzbekistan contended the frozen account belonged to Uzbekistan Airways and not the Republic. It argued in addition that the Romak's BIT claim did not appear to be *prima facie* valid. Mainly, Uzbekistan argued that a contract for the sale of wheat and an arbitral award are not protected investments under the BIT. The Court of Appeal of Paris rejected these arguments and confirmed the freezing order.

[30] Article 47 of ICSID Convention and Article 39 (6) of the ICSID Arbitration. See also the two recent decisions rendered by the UK Court of Appeal and The United States District Court of southern district of New York denying freezing injunction in connection with a BIT arbitration submitted to ICSID obtained by ETI, a Dutch Company, against the Republic of Bolivia and Empresa Nacional de Telecomunicaciones, *Entel SA, ETI Euro Telecom International NV v Republic of Bolivia and Empresa Nacional de Telecomunicaciones Entel S.A., [2008] EWCA Civ 880)*, available at http://www.bailii.org and *E.T.I. Euro Telecom International N.V v Republic of Bolivia and Empresa Nacional de Telecommunicaciones ENTEL S.A. (S.D.N.Y. July 30, 2008)* available at http://www.asil.org/pdfs/ilib080814.pdf. The English Court held that it had no jurisdiction to grant an injunction in support of ICSID arbitrations in the absence of the disputing parties agreement and also that the Respondents were, in any event, protected in these circumstances by sovereign immunity legislation.
The American Court rejected the request because 'ETI has brought an arbitration action against Bolivia, not Entel, and the attached bank accounts in New York undisputedly belong to Entel, not Bolivia without addressing whether the ICSID Convention prevents the Court from ordering the prejudgment attachment'.

[31] It should be noted that the present author was Romak's counsel.

[32] A special first instance jurisdiction which adjudicates disputes arising in connection with the enforcement of judgments.

[33] *Juge de l'exécution* of the Civil Court of Paris, Decision of March 31, 2008 in the matter of *Romak v Uzbekistan*, unpublished.

Regarding the notion of investment under the BIT, the Court stated that the investments protected include 'claims to money or to performance having an economic value', a very general definition covering Romak's rights in principle. The Court of Appeal also ruled that ICSID case law on the concept of investment was not pertinent to the dispute at issue, as the arbitral tribunal to which Romak had submitted its claim was set up pursuant to the provisions of the BIT under UNCITRAL Rules and not under ICSID rules.[34]

Another dispute illustrating this function occurred between Argentina's Salta Province and Teyma Abengoa SA,[35] a local Argentina company jointly controlled by a Swiss corporation and a Spanish corporation. In this case, the domestic courts intervened to support amicable negotiation proceedings, which are often required by investment treaties before submitting a claim to arbitration. Referring to a similar clause provided in the Argentina-Spain BIT and the Argentina Switzerland BIT, according to which any investment dispute must be settled amicably, the claimants asked the domestic court to issue an injunction to stop the Province from collecting tax, in order to facilitate an amicable solution of the dispute. The Argentina *Corte Suprema de Justicia de la Nación* pointed out that it was within its jurisdiction to implement international treaties concluded by the country and to enforce the respect of the amiable negotiation procedure. It therefore ordered the Province to refrain from bringing any tax enforcement action during that period.

A decision issued in US on the applicability of section 1782 on BIT arbitration reinforces the collaboration between investor-state arbitral tribunals and domestic courts. Section 1782 is a statutory provision authorizing federal courts to grant discovery assistance to persons involved in disputes before a foreign or international tribunal outside the US. In 2007, the United States District Court for the District of New Jersey held that Section 1782 allows discovery for use in an UNCITRAL arbitration initiated under the UK-Kyrgyz Republic BIT in Geneva.[36] The application was made by Oxus Gold plc against Mr Jack Barbanel, a US citizen. Oxus requested documents and a deposition from Mr Barbanel. The defendant opposed the application, principally arguing that the arbitration was a purely private commercial matter and that the BIT tribunal was not a 'foreign tribunal' within the meaning of the statute. The court notes that the BIT tribunal at issue was convened pursuant to the United Kingdom-Kyrgyz Republic BIT, which 'specifically mandates

[34] Cour d'appel de Paris, Decision of December 4, 2008, not yet published.

[35] CSJN, *Teyma Abengoa S.A. v Provincia de Salta*, Decision of July 18, 2002, available at http://fallos.diprargentina.com/2008/11/teyma-abengoa-c-provincia-de-salta.html

[36] Order dated April 2, 2007, Chief Judge Garrett E. Brown of the United States District Court for the District of New Jersey affirmed the ruling of Magistrate Judge Hughes, dated August 11, 2006.

that disputes between nationals of the two countries would be resolved by arbitration governed by international law' and concludes that the BIT tribunal constituted a 'foreign tribunal' for purposes of Section 1782.

This dialogue between domestic court and arbitral tribunal is further illustrated by a decision rendered by the Lebanese *Conseil d'Etat*, the supreme administrative court in Lebanon. Although hostile to contractual arbitral clauses, this decision paradoxically supported investor-state arbitration under a BIT. The dispute related to the execution of BOT contracts concluded in 1994 between Lebanon and Cellis and Libancell, two private companies, for implementing Cellular GSM Services. The BOT contracts provided for arbitration under ICC Rules. On the July 17, 2001, the '*Conseil d'Etat*', declared the ICC arbitration clause null and void on the ground that disputes arising out of concession contracts (administrative contracts) were under the exclusive jurisdiction of the Lebanese courts. However, the *Conseil d'Etat* decided that (Cellis), being 69% owned by France Telecom, was covered by the French-Lebanese BIT and was permitted to pursue UNCITRAL arbitration in accordance with this BIT. More specifically, the Conseil d'Etat referred to article 1.1 e) of the BIT that defines 'investments' as being 'concessions granted by law or by contract' and held that by allowing an investment arbitration in these matters, the BIT introduces an exception to the rule of that concessions are not arbitrable.[37]

Finally, it is important to note that domestic court intervention to grant provisional measures is not automatic but depends on domestic law, as a recent BIT dispute between Mr. Sancheti and UK illustrates. Sancheti's dispute relates in part to a disagreement with the Corporation of London, a local government authority, over the rent to be paid for leased premises. Mr. Sancheti brought arbitration proceedings against the UK under the India-UK BIT. He alleged 'blatant discrimination by different organs and functions of the United Kingdom in their dealings with him through the corporation of London, the Home Office, the Law Society, and the judiciary'. While Mr. Sancheti was pursuing his claim against the government of the UK, Corporation of London, as landlord for leased premises, filed a court action against him under the lease to recover unpaid rent. Sancheti was seeking to stay these court proceedings. According to English arbitration law, a party to an arbitration agreement

[37] Conseil d'Etat, July 17, 2001, *Revue de l'arbitrage* 2001, 855. See also *Vannessa Ventures Ltd. v Venezuela* in which a Venezuelan court prevented an investor from invoking an arbitration clause provided in a contract. The Constitutional Chamber of the Supreme Tribunal of Justice interpreting the 'fork-in-the-road' provision contained in the Canada-Venezuela BIT of 1996, decided that by bringing its claim to ICSID, Vannessa waived any contractual arbitration, Decision No. 3.229 of October 28th, 2005, available at http://www.tsj.govve/decisiones/scon/Octubre/3229-281005-04-2562.htm on this last case, see VJ Tejera Pérez, 'Investment Arbitration within the Legal Promotion and Protection Framework in Venezuela' *TDM* Vol. 5, issue 2 April 2008.

can apply for a stay in court proceedings on the ground that the matter is to be referred to arbitration. Sancheti's request was rejected. The Court of Appeal ruled that a stay of court proceedings can only be granted under English Arbitration Act of 1996 against someone who is either a party to an arbitration agreement or a person who is claiming through or under such a party. The Court found that the BIT arbitration agreement bound the UK government, but not the Corporation of London. It held that: 'The fact that in certain circumstances a State may be responsible under international law for the acts of one of its local authorities, ... does not make that local authority a party to the arbitration agreement'.[38]

C. Requests to Set Aside an Investment Award

Non-ICSID investment awards can be challenged before domestic courts, usually the courts of the place of arbitration. Requests to set aside an investment award are made in Canada,[39] the US,[40] Belgium,[41] England,[42] Switzerland,[43] Sweden,[44] Denmark[45] and in France.[46] Only in one case did a domestic court decide to annul an arbitral award rendered under an investment treaty.[47] All these proceedings usually involved

[38] *City of London v Ashok* Sancheti [2008] EWCA Civ 1283, available at http://www.bailii.org/ew/cases/EWCA/Civ/2008/1283.html.

[39] *Bayview Irrigation District et al. v Mexico*, Reasons for Judgment-Application for Set Aside, 5 May 2008, *Feldman v Mexico*, Review by Ontario Supreme Court, 3 December 2003 and Review by Ontario Court of Appeal, 11 January 2005, decisions available at http://www.economiasnci.gob.mx/sphp_pages/importa/sol_contro/consultoria/Casos_Mexico/Marvin/Marvin.htm.

[40] *Tembec et al. v US*, Memorandum Opinion of the US District Court for the District of Colombia on Tembec's application to vacate award, 14 August 2008, *International Thunderbird Gaming Corporation v Mexico*, Judgment of the US District Court for the District of Colombia on petition to set aside award, 14 February 2007, *Loewen Group, Inc. and Raymond L. Loewen v United States*, Judgment of the US District Court for the District of Colombia on petition to set aside award, 14 February 2007 (decisions available at http://ita.law.uvic.ca/ and infra).

[41] *Eureko B.V v Republic of Poland*, Tribunal of First Instance of Brussels, 23 November 2006 (available at http://ita.law.uvic.ca/) and, Brussels Court of Appeals, 26 November 2006, R.G. 2007/AR/29, unreported.

[42] *Ecuador v Occidental (2007) EWCA (Civ) 656*, *EMV v Czech Republic (2007) EWHC 2851* (available at http://www.bailii.org) and infra.

[43] *Republic of Poland v Saar Papier I*, Swiss Federal Court, Decision of 20 September 2000, *Poland v Saar Papier II* , Swiss Federal Court, Decision of 1 March 2002, *Republic of Lebanon v France Télécom Mobiles International SA & FTLM S.A.L*, 10 November 2005, decisions available at http://www.bger.ch and infra.

[44] *Mr William Nagel v The Czech Republic*, Svea Court of appeal, T 9059-03, 26 August 2005 available at http://www.sccinstitute.com/_upload/shared_files/artikelarkiv/william_nagel.pdf , *Franz Sedelmayer v the Russian Federation*, Stockholm District Court, Case no. T 6-583-98, 18 December 2002 and Swedish Court of Appeal, Case no. T 525-03, Decision of 02 June 15, 2005, Decisions available at http://www.chamber.se/filearchive/2/21315/franz_sedelmayer_russian_federation.pdf and infra.

[45] See infra.

[46] See infra.

[47] See infra.

the application of local arbitration law on vacating arbitral awards. However, some courts asked to hear a challenge have interpreted some investment treaty provisions.

Some decisions deal with the interpretation of the investor-state clause. In *Czech Republic v CME B.V*, the Svea Court of Appeal interpreted the choice of law clause found in Article 8.6 of the BIT between the Czech Republic and Netherlands.[48] In *Czech Republic v European Media Ventures SA*, the English High Court clarified the proper approach to interpreting BIT provisions and determining the scope of the arbitral tribunal's jurisdiction under Article 8 of Czech-Belgo Luxembourg BIT.[49] The High Court decided that this provision did not limit the arbitrators' jurisdiction to the issue of quantification but conferred substantive jurisdiction to determine whether compensation should be awarded.[50] In the *Republic of Ecuador v Occidental Exploration & Production Co*,[51] the High Court of Justice rejected Ecuador request to set aside an arbitral award rendered in London pursuant to the UNCITRAL Rules. Ecuador contended that the arbitrators had exceeded their jurisdiction by making an award on matters of taxation which, it claimed, were excluded by Article X of the BIT.[52] After a careful interpretation of this provision, the court found that, although Article X of the Treaty excluded matters of taxation from the scope of the Treaty, an exception was provided

[48] *Czech Republic v CME B.V*, Review by Svea Court of Appeal, 15 May 2003, 42 *ILM* 919 (2003), 90.

[49] Article 8:

> Disputes between one of the Contracting Parties and an investor of the other Contracting Party concerning compensation due by virtue of' [the expropriation provisions contained in Art.3(1) and (3)' …shall be submitted to arbitration before an ad hoc tribunal..].

[50] *Czech Republic v European Media Ventures SA,* Set aside application, England, Queen's Bench Division, 5 December 2007, available at http://ita.law.uvic.ca/.

[51] *The Republic of Ecuador v Occidental Exploration & Production Co.*, High Court of Justice-Queen's Bench Division (Commercial Court), March 2, 2006. See also decisions relating to the Justiciability of challenge to BIT award, Judgment of High Court of Justice regarding non-justiciability of challenge to arbitral award, 29 April 2005 and Judgment of the Court of Appeal, 9 September 2005, available at http://ita.law.uvic.ca/.

[52] Article X provides that:

> 1. With respect to its tax policies, each Party should strive to accord fairness and equity in the treatment of investment of nationals and companies of the other Party.
>
> 2. Nevertheless, the provisions of this Treaty, and in particular Article VI and VII, shall apply to matters of taxation only with respect to the following:
>
> (a) expropriation, pursuant to Article III;
>
> (b) transfers, pursuant to Article IV; or
>
> (c) the observance and enforcement of terms of an investment Agreement or authorization as referred to in Article VI (1) (a) or (b), to the extent they are not subject to the dispute settlement provisions of a Convention for the avoidance of double taxation between the two Parties, or have been raised under such settlement provisions and are not resolved within a reasonable period of time.

in Article X.2(c) when the dispute is connected to 'the observance and enforcement of terms of an investment agreement. The court concluded that the dispute, even related to taxation, concerned the performance of the obligations of the contract and had fallen within that exception. In the *Czech Republic v Saluka Investments BV*,[53] the Swiss Federal Tribunal ruled for the first time on the meaning of a provision under which any award rendered by an arbitral tribunal is to be 'considered as final and binding'.[54] The Tribunal held that it was not persuaded that the BIT Contracting States, by including this provision, had really intended to exclude any challenge to the award. In particular, the Swiss Court restated that such a waiver could be assumed only under very specific circumstances where the parties explicitly agreed. Furthermore, the Swiss Tribunal rejected one of the investor's arguments, according to which states being parties to a BIT would not accept interventions of judges seating in a third State.

There is also interesting domestic court case law on the concept of investment under investment agreements. The Maritime and Commercial Court of Copenhagen has observed that the concept of investment pursuant to the Latvia-Sweden BIT was to be widely interpreted and that there was no basis for a limited interpretation in the wording or structure of the BIT.[55] In the same vein, in *Kyrgyz Republic v Petrobart Limited,* the Svea Court of Appeal examined the provisional application of the Energy Charter Treaty to Gibraltar and interpreted the concept of investment under the Energy Charter Treaty. According to this Court, the definitions in Article 1 (6) and 1 (5) in the ECT must be interpreted as including the condensed gas supply contract signed by Petrobart.[56] Recently, in *Pren Nreka*, the Court of Appeal of Paris rendered an interesting decision on the interpretation of the notion of investment within the meaning of the Croatia-Czech Republic BIT.[57] Pren Nreka is a Croatian citizen and the sole shareholder of a Czech company ZIPimex. ZIPimex concluded a 'work agreement and lease' with the Prague Pedagogical Center, a State entity under the authority of the Czech Ministry of Youth, Schools and Physical Education. The agreement provides that ZIPimex was to renovate one of the two floors of the building occupied by the Center. In exchange, this Center was

[53] *The Czech Republic v Saluka Investments BV*, Swiss Federal Tribunal, Decision, 7 September 2006, *ASA Bull.* 1/2007, p. 123.

[54] Czech-Dutch BIT, Article 8(7):

> The tribunal takes its decision by majority of votes; such decision shall be final and binding upon the parties to the dispute.

[55] Decision of the Maritime and Commercial Court, Copenhagen, Case S-22-01, January 7, 2003, 2 *Stockholm Arb. Rep.* 266 (2003) at 278.

[56] Svea Court of Appeal, case T 5208-05, 19 January 2007 available at http://www.sccinstitute.com/_upload/shared_files/newsletter/images/svea_court_petrobart.pdf

[57] *Pren Nreka v Czech Republic*, UNCITRAL, available in English in *MEALEY'S International Arbitration Report,* Vol. 24, February 2009.

to rent approximately 300 square meters of the renovated space to ZIPimex for a period of fifteen years to operate a pizzeria. When the ministry decided to take possession of the entire building, including the space leased to ZIPimex, Mr. Nreka instituted arbitral proceedings against the Czech Republic pursuant to the Croatia-Czech Republic BIT and UNCITRAL rules. The arbitral tribunal fixed Paris as the seat of arbitration. On February 5, 2007, it rendered a partial award in which it held that the Czech Republic had failed to meet its obligation under the BIT. The Czech Republic sought to have this award set aside by the Paris Court of Appeal. In support of its application, the State asserted that the tribunal only had jurisdiction to hear investment disputes and that the dispute with Mr. Nreka did not involve an investment in the sense of the BIT. Besides, the Czech Republic claimed that the work and the lease agreement was a mere commercial transaction that could not be considered as an investment in light of five generally accepted criteria developed in ICSID case Law ([1] a significant capital contribution [2] significant duration [3] risk [4] a regular flow of profit for the investor, [5] and contribution to the host State's economic development.) The Paris Court dismissed this argument, holding that the contract was an 'investment' as envisaged by the BIT, which refers broadly to 'any kind of asset invested in connection with economic activities'. Pointing out that the 'BIT provisions … do not provide for any criteria identifying what is an investment, but rather give a list, that is moreover non-exhaustive, of cases considered an investment', the French court decided that the only test for jurisdiction was whether the transaction at issue was covered by the terms of the BIT. As the BIT's broad definition of investment includes, without limitation, any contractual right, the Court found that the transaction at issue constituted an investment under the terms of the BIT. Finally, the Court ruled against any transposition of tests developed by some ICSID tribunals to identify the notion of investment to non-ICSID investment arbitration.

As for the interpretation of other rules and standards included in investment treaties, it is worth noting that in *Mexico v Metalclad*[58] decision, the British Colombia Supreme Court entered into a detailed analysis of the correct interpretation of NAFTA Article 1105 (fair and equitable treatment) and Article 1110 (expropriation) in order to determine if the tribunal had exceeded its jurisdiction. The judge decided to partially set aside the award. This partial annulment is the only annulment by a domestic court of an award rendered by a tribunal constituted under an investment treaty. In *S.D. Myers, Inc. v Canada*,[59] the Federal Court of

[58] *Mexico v Metalclad Corporation*, Review by British Colombia Supreme Court, 2 May 2001 and Supplementary reasons for BCSC Decision, 31 October 2001, and Judgment of the Court of Appeal, 9 September 2005, available at http://ita.law.uvic.ca/.

[59] *Canada v S.D. Myers, Inc.*, Review by Federal Court of Canada, 13 January 2004.

Canada interpreted the notion of control under NAFTA's investment chapter. The Court decided that this concept must be interpreted broadly taking into consideration NAFTA objectives and principals of international law. The Court considered that the reference to the *Canadian Business Corporations Act* relied upon by Canada to determine whether an investor controls the investment was narrow, legalistic, restrictive and contrary to the objectives of NAFTA'.[60] The court also examined the relationship between different NAFTA chapters and considered that they overlap and that NAFTA rights are cumulative, unless there is a direct conflict.[61]

D. Enforcement of Investment Awards

Domestic courts may interpret investment treaties when they examine requests for enforcement of investment awards, mainly these rendered outside the ICSID system.[62]

A well-known enforcement procedure was between Franz Sedelmayer and Russia before the German Courts.[63] The German Supreme Court held that the arbitration clause in the Investment Protection Treaty between Germany and the Soviet Union of 1989 that referred to the New York convention and the ICSID convention did not constitute an implicit waiver by Russia of its immunity in enforcement proceedings.[64]

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[60] § 69.

[61] § 71.

[62] With regard to ICSID awards, Article 54 (1) of Washington Convention provides that 'Each Contracting State shall recognize an award rendered pursuant to the Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State'. There is some debate whether the obligation to enforce an ICSID award like a final judgment really excludes all objections against the award before domestic courts, (on this debate see, Edward Baldwin, Mark Kantor and Michael Nolan, Limits to Enforcement of ICSID Awards, *Journal of International Arbitration* 23(1): 1–24, 2006). Whatever the result of this debate, execution of the award shall be governed by domestic law (Art 54 (3)). Besides, Washington convention do not derogate from the law in force relating to immunity (Art 55). In *AIG Capital Partners v Kazakhstan*, AIG sought to execute its ICSID / BIT award against cash and securities owned by the National Bank of Kazakhstan located in London. This Bank claimed that the assets were immune from enforcement under the English State Immunity Act. Citing Article 55 of the ICSID Convention, the court held that bank's assets were immune from execution. *AIG Capital Partners Inc and another v Republic of Kazakhstan*, [2005] EWHC Comm. 2239, October 20, 2005, available www.bailii.org/ew/cases/EWHC/Comm/2005/2239.html.

[63] There are enforcement procedures in Sweden too, Svea Hovrätt, case no. 1942-09 (March 19, 2009) and case n°2706-08 February 12, 2009.

[64] The argument concerns Article X of the Germany/Russia BIT, which states that the 'award shall be recognized and enforced in accordance with the Convention on the recognition and enforcement of Foreign Arbitral Awards of 10 June 1958'. I think however that the German Court rejected this argument on the basis of the peculiarities of the German-Soviet BIT and that with other BIT's, a different result might be justified.

In *SwemBalt v Latvia*,[65] Latvia opposed enforcement of the award rendered by the SCC in Copenhagen under the Latvia-Sweden BIT. Latvia asserted that the tribunal had exceeded its mandate because the award contained decisions on matters which were beyond the scope of the arbitration agreement. According to Latvia, enforcement should have been refused in accordance with section 54 paragraph 3 of the Swedish Arbitration Act because 'a ship bought for the purpose of a floating trade Centre' did not constitute an investment within the meaning of the Latvia-Sweden BIT. Ruling on the recognition and enforcement of the award, the Svea Court pointed out that whether the subject of the award constituted an investment within the meaning of the BIT was not a matter to be examined by the court and issued an order to enforce the award.[66]

V. Conclusions

The emergence of national jurisprudence on investment treaties opens new areas. If there are any things to look for after this general survey, one of them certainly is whether national courts will develop fair, consistent and uniform interpretation of investment treaties. It is also important to observe what kind of impact such case law will have on investment arbitral tribunals. Not only can previous domestic court rulings have a persuasive effect on investment tribunals, but they can also affect the validity of the arbitral awards. For example, A BIT/UNCITRAL arbitral tribunal seated in France could not ignore the broad definition of investment adopted in French case-law. This dialogue between national and international judges was foreseen by Thomas Wälde, who called for 'cross-fertilization'[67] and analogies between courts and tribunals.[68]

[65] Decision of the Svea Court of Appeal, Stockholm, Case Ö 7192, October 29, 2002, 2 *Stockholm Arb. Rep*. 266 (2003). See also the comment by Ch. Liebscher, *ibid.*, at 280.

[66] It seems that there is an enforcement procedure in s*aar paper* in Germany.

[67] T Wälde and W Ben Hamida, 'The Energy Charter Treaty and corporate acquisition: The arbitrability of ECT pre-investment (access) rights, investment character of tender offers and parallel application of Energy Charter Treaty and European Community law' in *Investment protection and the Energy Charter Treaty* (G. Coop and Cl. Ribeiro ed., Jurisnet 2009) 220.

[68] T Wälde, Separate Opinion, *Thunderbird v Mexico*, January 26, 2006, § 13. 'More appropriate for investor-state arbitration are analogies with judicial review relating to governmental conduct – be it international judicial review (as carried out by the WTO dispute panels and Appellate Body, by the European- or Inter-American Human Rights Courts or the European Court of Justice) national administrative courts judging the disputes of individual citizens' over alleged abuse by public bodies of their governmental powers. In all those situations, at issue is the abuse of governmental power towards a private party that did and could legitimately trust in governmental assurances it received'.

The Changing Face of Political Risk in the Energy Industry

Mirian Kene Kachikwu*

I. Introduction

The past year has proved to be one of the most politically charged years in recent history. Global events have repeatedly threatened to impact multinational business operation – presidential elections in the US, the global financial crisis, the rise and fall of oil prices, etc. According to a global survey of 602 executives carried out by Economist Intelligence Unit (EIU), [1] political risk is now perceived to be greater than economic risk, and this asymmetry is a significant shift in the analysis of political risk. The world has become a global and highly interconnected market place. Internationalisation and investments in emerging markets have also increased. Oil and gas extraction – considered riskier than other sectors, with contract renegotiations, nationalizations and rising domestic ownership ceilings – presents a larger pool of political risks.

Politics influences all of the external risks firms face. Unexpected events, from terrorist attacks to governmental change, can cause political shocks across the globe. Whether it is the threat to energy prices from sudden crises in Iran or Nigeria, or the growing risks of protectionism from developed countries, politics create risks, and opportunities, for all energy companies. Due to the fact that the world's oil and gas production pattern is directly related to the geopolitical location of reserves and that the energy industry is very high profile and often controversial in every country in which private upstream and downstream petroleum operations exist, political risk management in the energy industry plays an increasingly vital role.[2] Energy companies are also now establishing hubs for strategic activities in countries with supportive regulatory environments and deep reserves of talented, well-educated, highly-skilled workers. A shock to one link in this lengthening chain can now disrupt production with unprecedented ease.

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[1] Findings reported in EIU, World Investment Prospects to 2011,(2007)

[2] A. Berlin, 'Managing Political Risk in the Oil and Gas Industries' (February 2004) 1:1 *Transnational Dispute Management*.

How can corporate leaders predict, measure and monitor political risks? How can business leaders capture opportunities in new markets or adequately manage risk across their global portfolios? How can they obtain unbiased information and make sense of the complex web of information that surrounds these risks? This article highlights some trends of change in the political risk arena and shifts in the concept of political risk. It does not, however, analyse the specific tools used in the management and mitigation of such risks.

II. Understanding Political Risk

The identity of political risk, a rather controversial concept, crosses the boundaries of specific social sciences and its analysis stimulates a multi-disciplinary debate. Thus, political risk analysis bridges assorted methodologies and approaches and focuses on how political environments of economic action differ from one another between societies, and how those differences can be managed by states and companies.[3] Set against this diverse background, the concept of political risk lacks a canonical definition. Instead, it is a large and an amoeba-like category.[4] As the diversity of definers and the historical context suggest, there are many distinct ways of defining political risk. The definition would generally depend on the perspective of the definer and the import attributed to the relevant political risk. In the energy industry, for instance, there is often a direct correlation between an energy company's analysis of the significance and degree of political risk and the degree of geological potential of the proposed investment area.

Within the context of the contemporary global financial crisis, there is an emergent interest in the discourse on the link between political institutions and political risks facing energy companies. Political risk does not result from the type of political system in place in the host country. It is the changes to the political and socio-economic conditions of a country or the energy sector that result in political risk.[5] The long term nature of energy projects and investments render energy companies particularly sensitive to changes in the conditions of operation. Seeing political risk as part probability and part impact provides insight into political risk. For an energy company, the implication for political risk is that there is a measure of likelihood that political events may complicate its pursuit of earnings through direct impacts – taxes, for instance – or indirect impacts – an opportunity cost relinquished.

[3] A Loikas, 'A Government Analysis of Political Risk: Exploring Equilibrium, Instability and Pluralism at Local, National and Supranational Level in Europe' *Turun kauppakorkeakoulun julkaisuja, sarja* A4: 2003, 297.

[4] See generally, A Sandström, 'Political Risk and Firm Default Probability – Exploring Export Credits to High Risk Countries', Department of Finance and Statistics, Swedish School of Economics and Business Administration, November 2006.

Understanding the nature of political risk, as well as how to incorporate political risk into management information systems, is imperative to making sound business decisions. First, it must be modelled into the initial investment decision. Second, once a project is approved, and then becomes operational, political risk needs to be monitored on a continuing basis and built into management information systems.

III. A Historical Framework

Political risk has undergone periods of interesting transformations over the past decades. In the period from 1960s to the end of 1970s, some countries that had just regained their sovereign independence from colonial powers tried to overcome their lack of capital by simply taking over the foreign subsidiaries of multinational corporations (MNCs). Thus, concepts like confiscation, expropriation and nationalization became critical concerns for companies with foreign operations. This period was dominated by the analysis of MNCs and their exposure to political risk. A majority of those organizations shied away from political risk and predominantly relied on external organizations to assess risk, such as insurance companies.[6] The crises in Mexico in 1994, Asia in 1997, Latin America in 1999 – 2002, as well as the Russian default in 1998 contributed to the evolution of the ensuing political risk paradigm. Through these events, political risk research shifted its attention to 'financial crises' and the identification of early warning indicators for such crises. Quantitative risk assessment methods were developed along with the probabilistic interpretation of country and political risk. A refinement of the political risk concept emerged with the systematic use of these quantitative approaches also on the corporate level.[7]

IV. A Contemporary Contextual Trend

While the nature of business practice in politically risky countries remained constant, the context in which companies operate dramatically changed in the last decade. The risk environment continues to evolve. Traditionally, political risk in the energy industry referred to risks resulting from the action or inaction of host governments. When one thought of political risk, one usually meant things like expropriation and

[5] Governments intervene in the domestic marketplace to attempt to accomplish a wide variety of goals, including correcting for market failures, to shift income among groups, to raise revenues, and to advance particular social, political, or environmental goals.

[6] M Lindeberg & S Mörndal, 'Managing Political Risk – A contextual Approach, Ekonomiska Institutionen Linköping' (2002). See generally, A Kolo, 'Managing Political Risks in Transnational Investment Contracts' *CEPMLP Internet Journal*, www.cepmlp.org, vol. 1, article 4. See also JD Simon, 'Political Risk Assessment: Past Trends and Future Prospects' (Fall 1982) *The Columbia Journal of World Business, Columbia Business School* 62-71.

[7] A Sandström, Supra n. 4.

nationalisation, war or civil unrest and currency inconvertibility. This is no longer the case as most energy projects now face an array of inter-related 'mid-tier' risks. New categories have materialized in the past decade, many of them more difficult to quantify than 'traditional' risks, both in terms of their frequency and their severity. While the traditional risks are certainly still relevant, relative to other types of political risk, they are occurring with less frequency and ferocity.

A rising new wave of resource nationalism, with countries such as Russia, Nigeria, Libya, Venezuela[8] and Bolivia[9] demanding a greater piece of the energy pie, is compelling energy companies to contend with changes in royalty contracts and income taxation. Major energy-exporting nations are tightening their grip on upstream production. This has contributed to the prevalent reliance on international growth often pursued in new and unfamiliar markets. This shift to more uncertain investments demands a more systematic approach to global portfolio management which looks beyond, for example, how short-term currency fluctuations and security concerns affect general market conditions to how political conditions influence a specific company's longer-term prospects and volatility in its markets across the globe.

The international rule making arena also continues to change. From a grand macro-historical outlook, with India and China both growing at more than 8 per cent per year, whilst the G-3, US, Europe and Japan are growing at less than 2 per cent a year[10], the relative power between the mature economies and the emerging markets is changing dramatically. In 2007, developing and transition economies attracted more foreign direct investment flows than ever before. While global foreign investment flows are projected to decline, those to the developing and transition economies are expected to suffer less despite the current financial and credit crisis.[11] Focussing on oil and gas reserve holdings, 14 of the world's top 20 upstream oil and gas companies are NOCs.[12] NOCs now have more ability than ever before to shape the market in ways that have worldwide impact. The US$4.2 billion acquisition of Petrokazakhstan by China National Petroleum Corporation illustrated this. This has raised

[8] In February 2008, Venezuela threatened to cut off the US oil sales after one of the world's four largest oil companies won international court orders freezing up to $12bn in assets of state oil firm Petroleos de Venezuela (PDVSA).

[9] The 2007 experience of Petrobras after Bolivia's demand that all oil and gas companies operating in the country have 180 days to enter into new contracts with the state company YPFB illustrates this. event was closely followed by Bolivia's neighbouring country, Ecuador taking control of Occidental Petroleum's, then Ecuador's largest investor, operations three days after cancelling the US company's contract.

[10] A Sheng, 'Global Financial Crisis and Asian Responsibilities', *East Asia Forum*, March 7th 2009, p 1.

[11] UNCTAD, World Investment Report, 2008.

[12] Marsh, 'The Impact of Risk On National Oil Companies' (2007).

the supplementary question of whether government or state-ownership should matter in the treatment of applications to invest. When confronted by Chinese government-controlled foreign investment confusion was introduced into Australian foreign investment policy.[13]

V. The Shifting Paradigm of Political Risk

Over the past few years, many of the underlying political risks have changed, with some types becoming more associated with economic crises and less with wilful political acts of governments. New risks containing immaterial or intangible aspects have emerged, adding a new dimension to risk management. A basic understanding of the technical aspects of the economic cycle, business decision making and resource projects is now required to evaluate political risk. General perceptions change and develop; new political risks are defined that did not previously exist and which are either uninsurable or still years away from the availability of an affordable, well-structured insurance product. Many of the new categories are not transferable and require an across-the-firm approach as well as industry working with governments and society to address them. The face of the political risk paradigm is shifting with every risk wearing assorted masks as highlighted below.

A. From 'Government' Action to 'Political' Action

National governments are no longer the only, or even in many cases the primary source of political risk in energy projects. Political risk may now arise from local governments, international and local NGOs, community groups, local competitors or any other group advancing political objectives. The categories of issues that energy companies now have to deal with are thus quite divergent – from dealing with things like corruption, NGO scrutiny, maintaining a local or global social licence to operate, a lack of clarity over the implementation of energy legislation through to poor infrastructure and HIV/AIDS. This flattening of political risk has been brought about by a variety of factors – decentralisation of governance in many emerging market economies, the enhanced ability of NGOs to scrutinise energy companies in remote locations via information technology and a rising level of expectations of behaviour on energy companies by shareholders and the general public.[14] This requires innovative skills in creative business thinking

[13] M Thirlwell, 'Sharing The Spoils Of China's Rise Means Negotiating Some Tricky Investment Twists And Turns' in *The Australian*, 7 July 2008. See also, Peter Drysdale and Christopher Findlay, 'Chinese Investment in Australian Resources' in *East Asia Forum*, September 4, 2008.

[14] 'Working in a Changing World: A New Approach to Risk Mitigation in Zones of Conflict' Collaborative for Development Action', http://info.worldbank.org/etools/docs/library/57507/WorkinginaChangingWorld.pdf downloaded on 11/04/2009

including building community trust. New multi-stakeholder approaches with civil society groups and local governments demand different levels of dexterity and expectations and a more pro-active approach. While this creates a critical challenge, it also creates an interesting reality – more than ever before, energy companies are in a position to influence and control the above-ground risk environment they face. This is the challenge and at the same time, the opportunity.

B. Political Risk Becoming Energy Risk

Some major producers and consumers have been using energy as a political lever as awareness of the vulnerability of pipelines and the potential impact of supply chain interruption has increased. A policy paper from the European Commission to the European Council highlighted, as a serious risk, the increasing dependence on imports from unstable regions, suppliers and external actors that are not subject to the same market rules or competitive pressures domestically.[15] In the past few years, Russia has demonstrated its willingness to intervene in the oil and gas industry to reward and punish nations and corporations in response to political imperatives. The most heavy-handed instance was the repeated gas cut-off to the Ukraine. Other instances include the pipeline cut-off to a Polish-owned refinery in Lithuania and the diversion of crude away from the largest refinery in the Baltics in 2005.[16] In April 2009, Spanish secret service agency, Centro Nacional de Inteligencia (CNI), accused Russian state-owned Gazprom, of negotiating with some African gas-producing countries, to 'take control of energy sources beyond Russia's borders' so as to 'become the sole supplier of gas to Europe'. CNI maintained that Gazprom was bent on controlling the Trans-Saharan Gas Pipeline project linking Nigeria to Europe, via Niger and Algeria.[17]

C. The Impact of a Global Financial Crisis

The prevalent global financial crisis has demonstrated that the global economy remains deeply interconnected and dependent on forging compromises between domestic politics and international capital. Cognisant of the political instabilities that naturally emerge from such a serious global economic downturn, many energy companies are caught

[15] R Amsterdam, 'In Russia, Political Risk Is Energy Risk' August 15, 2006

[16] This move was interpreted as punishment for having sold the former Yukos asset to the Polish company PKN instead of LUKoil. Poland was also seen as having fallen out of the Kremlin's favour for its vocal opposition to the North European Gas Pipeline

[17] CNI also alleged that the plan was behind 'major energy cooperation agreements' between Russia and some Latin American countries - Venezuela, Bolivia and Brazil See http://www.presstv.ir/detail.aspx?id=91003&sectionid=3510213, downloaded on April 20, 2009.

in a kind of 'suspended animation' awaiting the outcome of the crisis. Underlying the market volatility are two important structural forces which provide a useful context for the unprecedented levels of political risk.[18] First, there is more state intervention in the global economy. Second, the intervention is both reactive and uncoordinated by a series of local, regional, and national political actors who have decidedly non-global, and often non-market, views of the cost/benefit equations that besiege their policy decisions. In effect, politics is driving the global economy more directly, and more inefficiently, this year more than at any point since World War II.

Political risks have historically been most important for economic outcomes in emerging markets, but the current financial crisis has created an unprecedented space for government interference in economic affairs within developed states too. A dynamic is unfolding – economic power has shifted from New York to Washington, from Shanghai to Beijing, from Mumbai to New Delhi, and from Dubai to Abu Dhabi. As a result, domestic political factors are driving the performance of markets. Ultimately, the crisis is political. It may have erupted as a financial crisis but its resolution is inexorably political. In the energy industry, however, the most risky countries are not necessarily those that are most exposed but rather those that possess the least flexibility to respond.

The prevalent global financial crisis will be seen in history as a major turning point, just as the 1930s Great depression changed the financial landscape for nearly 80 years. Similarly, the present crisis will stimulate major transformation in economic theory, philosophical perspective and in institutional configuration. What impact will this have on the future strategic leverage of the West in general and the US in particular? It has been argued that the current crisis is a major geopolitical setback for the US and Europe.[19] The fact that this is occurring at the same time as major new historic forces proclaim the emergence of China and the resurgence of Russian nationalism may be perceived as a severe setback for the US and the European model of modern capitalism.

D. Essential Security Interests

When a government is faced with a regional or global financial crisis, where should the balance be drawn between protecting investors against

[18] I Bremmer, *Top 10 Risks of 2009*, Eurasia Group, January 2009. See also I Bremmer and Preston Keat, *The Fat Tail: The Power of Political Knowledge for Strategic Investing* (Oxford University Press, 2009). See also, J Ewing, 'Economic Woes Raising Global Political Risk' in *Business Week*, March 10, 2009.

[19] A Sheng, 'From Asian to Global Financial Crisis', Third KB Lall Memorial Lecture, Indian Council for Research on International Economic Relations, 7 February, 2009, New Delhi.

unfair or excessive regulation, and providing public authorities with the ability to prevent harm or enhance the economy? If an energy investor encountered problems in gaining access to foreign exchange, should the host government be held responsible for not holding enough reserves? When does the passage or implementation of a law or regulation done for a public purpose that reduces the value of an asset constitute a 'regulatory taking' that is indistinguishable, analytically, from a 'physical taking' of the sort associated with expropriation? This is the essential security interest justification or the 'necessity' exemption – a vague exemption assessed in a range of cases brought against Argentina in the aftermath of its 2001-2 financial crises. In those cases, particular tribunals found that the adverse societal effects of financial crisis might engage a state's 'essential security interests'. In September 2008, an ICSID tribunal rejected all but one of the claims made by a foreign investor against Argentina, largely on the basis that the measures taken by Argentina were justified by 'necessity'. It concluded that Argentina's conduct, in the face of economic and social crisis, conformed 'by and large' to the conditions for derogating from its obligations under the relevant US-Argentina BIT.

E. Terrorism

Traditionally, the insurance market has treated terrorism risk and political risk as two distinct segments of the insurance market. Terrorism has become a universal phenomenon and it has also become clear that terrorism and political risk cannot be separated when operating in areas where the terrorist organisations may have significant local support. There is also a general trend towards decentralised autonomous terrorist cells operating in both the developed and developing world. This implies that the boundaries of what may have been considered locally-based terrorism can migrate with alarming speed via already established networks. In today's turbulent political, social, economic and financial environment, terrorism ranks among the principal political risks that governments and energy companies have to face, especially in the South Asian region.[20]

F. Piracy

The seizure, by Somali pirates, of a Saudi oil super-tanker in November 2008, showed how much at risk global oil and gas shipping is to disruption. It calls to mind the attack in 2002 on the French super-tanker Limburg, which spilled 90,000 barrels of oil into the Gulf of Aden. For the energy industry, the most immediate impact has been felt in escalating political risk insurance premiums. The impact of Somali

[20] See generally, I Bremmer, *Top 10 Risks of 2009*, Eurasia Group, January 2009, p 2.

piracy on premiums shows the extent to which costs can suddenly spike – increases for crossing the Gulf of Aden may have leapt to $20,000 per vessel per transit from $500.

G. Accountability to an Outside Agency

The international investment arena is increasingly fraught with variable and evolving ethics and compliance standards, including in a company's home country. US regulatory changes – Sarbanes-Oxley Act and Patriot – are a case in point. The theme that conjoins all of the compliance standards is that of accountability to an outside agency. This is one of the most complex elements of the new regulatory environment. This evolving regulatory environment is just one example of the nascent transition which will see increasing scrutiny of investment and operations, and demand constant awareness and adaptation to keep up with compliance challenges.

H. Global Risk Impact Misalignment

In 2005, the World Economic Forum (WEF) launched the Global Risks Program with the goal of identifying and analyzing current and emerging 'global risks'. [21] Through this initiative, the pivotal role of the energy sector in a large number of the identified global risks became apparent. These risks ranged from the relatively clear relationship between oil prices and global economic performance to the more complex issues of oil politics and international relations, the most obvious for the energy sector being long-term energy security. The demand for energy has been rising with economic growth at a steady rate of 2% per annum, while supply from existing production fields is declining at approximately 5% per annum. The IEA has clearly laid out the need for investment to bridge the 7% growth gap between supply and demand.[22]

Unfortunately, the combined effect of the long-term uncertainty on the energy industry and the global financial crisis is a conservative approach to investment which may fall short of those needed to guarantee long-term energy security. This may have the undesirable long-term consequences of increasing real energy prices and a public view of the industry as profiteering from tight supply conditions. Such an environment leads to a misalignment where governments and the energy industry have divergent interests, with governments often attempting to address any perceived imbalances in the energy industry. Examples of the misalignment can be seen through examples

[21] O Wyman 'Realigining Risks and Rewards in the Energy Sector: Why today's risk assessment may not support tomorrow's energy security', *Corporate Risk Research Report* 2006 – 2007.
[22] ibid, p 10.

of government behaviour in both developed and emerging economies. In the US, the CEOs of the oil majors were called before the US Senate to explain the record industry profits. There have also been proposals to tax the profits to ease the winter heating bill for low-income families. In the UK, the Chancellor of the Exchequer imposed a tax on oil companies in 2005 widely seen as a 'raid' on excessive profits. In Bolivia, the government raised royalty levels to 56% causing most majors to pull out of the country. In Venezuela, various government actions including retrospective taxation created a climate of conflict between energy companies and the society as a whole. Each of these instances can be considered a secondary effect to the global risk misalignment.

VI. Looking into the Future

As global markets become increasingly linked, foreign policy begins to directly affect business interests locally and globally. Energy companies are exposed to a wider variety of political risks in many more places than ever before. The business value chain is significantly longer and more complex and exposed to increased risk and variability. The rate of change continues to accelerate, so today's risks are taking new shapes and posing new threats and opportunities. Long-term sustainable success internationally depends to a considerable extent on an energy company's ability to grasp the implications of political risk and apply them to business risk. This means moving beyond avoidance and anxiety about political risk toward a structured way of seeing risk as a precursor of both economic risk and opportunity and as such, constitutes a fundamental paradigm shift. Looking into the future, the following are inevitable:

- Elevation to, and integration of, effective management of political risk into the highest levels of business strategy with risk transfer and insurance purchase becoming the last steps in a long process of risk assessment, prioritization and treatment;
- Better insight into the interconnection of risks, more ingenious creation of coalitions amongst multi-stakeholders to manage risk, and more appropriate identification of the different trade-offs between risk mitigation solutions;
- Better dialogue between emerging and developed countries, energy companies and the government and regulators to effectively address the current misalignments of incentives;
- Energy companies must work together with governments to consider the interdependency and potential magnification of political risk; the impact of local and international pressures on investment and operational decisions and to help manage the increasingly scarce stock of global resources.

- Routine collection of new information, dissemination, analysis and timely action and integration into economic capital calculations or other risk metrics. Companies will use these metrics to measure risk against earnings or growth objectives, intelligently reallocate capital across business units and modify their overall strategic direction.

Fat Cats and 'Windfall' Taxes in the Natural Resources Industry: Legal and Policy Analysis in the Light of Modern Investment Treaties

Abba Kolo*

I. Introduction

In the last few years, the world has witnessed a resurgence of resource nationalism in minerals producing countries – mainly oil and gas, gold and copper – aimed at 'limiting the operations of private international oil and gas [and mining companies] and asserting greater national control over natural resources development'.[1] Resource nationalism is expressed in several ways; including increased state participation and imposition of 'windfall taxes' – in some cases retroactively. Some have sought to justify the taxes on the ground that it was fair for the producing states to claw back some of the perceived 'excessive' profits made by the companies due to the astronomical rise in prices,[2] while critics have pointed out that the taxes would act as disincentives for future investment by the companies in high risk projects with probable negative consequences on security of supply and prices. The purpose of this chapter is to analyse the legal consequences of such taxes under modern investment treaties,[3] in particular, it aims to find out to what

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[1] P Stevens, 'Oil Wars: Resource Nationalism and the Middle East' in P Andrews-Speed (ed) *International Competition for Resources: The Role of Law, the State and of Markets* (University of Dundee Press, 2008) 11; G Joffe, et al, 'Expropriation of Oil and Gas Investments: Historical, Legal and Economic Perspectives in an New Age of Resource Nationalism' (2009) 2:1 *J. W.E.L. & Bus*. 3; A Brunet & J Lentini, 'Arbitration of International Oil, Gas, and Energy Disputes in Latin America' (2007) 27 *NW. J. Int'l. L. & Bus*. 591, 621-624. For an overview of historical and recent contractual/tax changes by oil producing countries and the underlying political and economic argument for such changes, see D Johnson, 'Changing Fiscal Landscape' (2008) 1:1 *J. World Energy Law & Bus*. 31.

[2] This is based on the general conception that as owners of the natural resources, 'proceeds from their extraction should go mainly to the owners.' C Nakhle, *Petroleum Taxation* (Routledge, London, 2008) 114-115. A related argument has been made by politicians in the home states of some of the oil companies to urge for the imposition of windfall taxes on the companies to help reduce the effect of high fuel costs on low income consumers. See, 'Windfall tax and blue-chip exodus spell double trouble for Darling', *Financial Times*, 31 August, 2008; '2 Energy Bills, Including Windfall Tax, Stall in Senate', *New York Times*, 11 June, 2008; 'The Windfall Profit Tax', *New York Times*, 9 November, 2005.

[3] This seems to be the main legal question raised by some of the latest tax-related investor-state arbitrations such as *City Oriente v Ecuador*, ICSID Case No. ARB/06/21 (case discontinued after settlement by the parties); *Sergei Paushok v Mongolia*, available at http://ita.law.univ.ca.

extent a windfall profit tax measure of a host state might violate the expropriation provision of such treaties,[4] and by extension, the policy implications of such taxes on the flow of foreign investment.

The main thesis is that notwithstanding the wide margin of appreciation enjoyed by states in respect of tax matters, it should be counter-balanced by the need to protect the proprietary rights of the private investor, including the right to enjoy the profits earned and/or legitimate expectations of enjoying the same, against deprivation by the state. Such a right should constitute a protected investment susceptible to expropriation distinct from the underlying investment. This argument is made more compelling in a situation in which the investment agreement was entered into recently based upon a contemporaneous law(s) enacted by the host government aimed at inducing foreign investors or based on assurances of tax stability made by the host government. From the investment promotion policy perspective, protecting such category of proprietary rights against opportunistic state actions is economically more efficient.

A. Political and Legal Context

Just as in the 1960s and 1970s, the current assertiveness by minerals producing countries for greater control over their natural resources is driven by a number of factors including ideological conception of the role of the state in the economy, nationalism and xenophobia, and more importantly, increase in oil and gas and minerals prices.[5] But unlike in the 1960s and 1970s, when the main justification raised by the producing countries was the need to 'remove the after-effects of colonial rule, inherent in those agreements',[6] most of the current agreements

[4] Although tax matters are carved out of some of the disciplines under most investment treaties, nonetheless, the expropriation discipline is generally applicable to tax matters, and many arbitral tribunals have acknowledged the fact that expropriation might occur through taxation. eg *Feldman v Mexico*, ARB (AF)/99/1 ICSID at para 116 (Dec. 16, 2002); *Occidental v Ecuador*, No. UN 3467 London Ct. Int'l Arb. at para 85 (July 1, 2004). See generally, T Wälde & A Kolo, 'Coverage of Taxation under Modern Investment Treaties' in Muchlinski, et al (ed), *The Oxford Handbook on International Investment Law* (OUP, 2008) 305; A Kolo, 'Tax "Veto" as a Special Jurisdictonal and Substantive Issue in Investor-State Arbitration: Need for Reassessment?' (2009) 32:2 *Suffolk Univ.Tran'l. Law* 475.

[5] Stevens, supra (n. 1); T Wälde, 'The Rule of Law and the Resources Industries' Cycles' in Andrews-Speed (ed), supra (n.1), 137; Brunet & Lentini, supra (n. 1), 622-23; K Jacobs & M Paulson, 'The Convergence of Renewed Nationalism, Rising commodities, and 'Americanisation' in International Arbitration and the Need for More Rigorous Legal and Procedural Defenses' (2008) 43 *Texas Int'l. L. J.* 359, 381-83.

[6] On the significance of the differences in the historical context and possibly legal consequences of the 1960s and 1970s oil agreements from the subsequent ones see, J Voss, 'The Protection and Promotion of Foreign Direct Investment in Developing Countries: Interests, Interdependencies, Intricacies' 31 *ICLQ* (1982) 686, 692; R Higgins, 'The International Law Perspective' in T Daintith (ed), *The Legal Character of Petroleum Licences: A Comparative Study* (1981) 35, 47.

sought to be re-arranged by the producing countries were entered into by sophisticated governments in the 1990s – in most cases after an open bidding process – based on laws specifically enacted by the states to induce foreign investment in geologically high risk projects.[7] And in order to entrench the liberal policies of the 1990s and reassure the foreign investors, most of the minerals producing countries also signed bilateral or multilateral investment treaties, mainly with capital exporting countries, thereby internationalising their commitments.[8]

[7] For instance, beginning in 1992, the Venezuelan government re-opened its doors to foreign investors under the 'Apertura' policy. It signed several service agreements with international oil companies, including ExxonMobil and Statoil, to explore and develop oil in the high risk Orinoco Belt. 'In order to incentivise the foreign investors, PDVSA (the national oil company) capped the royalties to be paid these projects at 1 percent, as opposed to the 16.6 percent maximum available at the time. Likewise, these associations were only subject to a 34 percent income tax rate – the rate normally applicable to non-oil activities. Moreover, in all four joint ventures, the foreign companies held the majority shares' and 'in all the association contracts, it was explicitly stipulated that under no circumstances would PDVSA be allowed to become a majority partner.' B McNew, 'Full Sovereignty over Oil: A Discussion of Venezuelan Oil Policy and Possible Consequences of Recent Changes' (2008) 14 *Law & Bus. Rev. Am*. 149, 153 (footnotes omitted); Jacobs & Paulson, supra (n. 5), 371-75. However, in 2004, the Venezuelan government suddenly raised the royalty rate from 1% to 16.6% and to 33% in 2006. In addition to these increases in taxes, in 2008, Seniat, the Venezuelan tax agency imposed taxes on the oil companies, back dated to 2001 on the ground that the companies were classified incorrectly by the Venezuelan authorities during the 'Apertura' in the 1990s which saw the companies paying 34% income tax rate instead of the 50% applicable to oil operations. A Windfall Profits Law was also enacted which imposes on the oil companies a 50% tax per barrel of the excess of the average price on a given month over $70 with the rate rising to 60% when the average monthly price exceeds $100. J Dargin, 'The Rising Tide of Expropriation in Venezuela: A Look at 21st Century Resource Nationalism' 5:2 *TDM* www.transnational-dispute-management.com (2008) at 6-9; E Eljuri, 'Venezuela's Exercise of Sovereignty over the Hydrocarbon Industry and Preventive Protections to be Considered by Investors' (2008) 5:2 *TDM*. Aside from the significant reduction in the profit margin of the companies, the change in the classification of the companies' activities for tax purposes from 34% to 50% and consequent back dated taxes raises the legal question as to whether the principle of estoppel or good faith would apply to hold the Venezuelan government bound by the conduct of PDVSA vis-à-vis the oil companies. It also raises questions over the constitutionality of such retroactive legislation under Venezuelan law. See, E Eljuri & M d'Empaire, 'New Legal Framework for Hydrocarbon in Venezuela' (2002) 20 *J.E.N.R.L.* 296, 302-303.

Similarly, some agencies of the Nigerian government (including the National Assembly and the courts) have recently questioned the legality of the fiscal stability guaranteed foreign investors under the Liquefied Natural Gas Law of 1990 in order to develop the country's LNG project at a time when the country was politically isolated. See B Adaralegbe, 'Stabilising Fiscal Regimes in Long-Term Contracts: Recent Developments from Nigeria' (2008) 1:3 *JWELB* 239.

On the increasing sophistication of host governments in negotiating natural resources development agreements see, D Johnson, *International Exploration Economics, Risk and Contract Analysis* (PennWell, 2003) 53; M Gillis, 'Evolution of Natural Resource Taxation in Developing Countries' (1982) 22 *Nat. Res. J.* 619.

[8] O Garcia-Bolivar, 'Investor-State Disputes in Latin America: A Judgment on the Interaction between Arbitration, Property Rights Protection, and Economic Development' (2007) 13 *Law & Bus. Rev. Am.* 67, 72; J Salacuse, 'The Treatification of International Investment *Cont.*

Aside from enhancing the capacity of the state parties to make credible commitments, these treaties concretise the international standard of protection to be accorded foreign investors and provide external discipline on host state regulatory and administrative measures.[9] The treaties reflect a broad consensus among countries on the standard of treatment to be accorded for foreign investors under international law, thereby diminishing the uncertainty under customary international law as witnessed in the 1960s and 1970s.[10] In our opinion, these developments should provide the policy and political context within which to analyse the legal consequences of the recent windfall tax disputes between minerals producing countries and foreign investors.[11]

Section one argues that given the broad definition of 'investment' under most investment treaties as including any asset that has economic value, profits and the legitimate expectations of earning same should constitute a protected asset susceptible to being expropriated when the host state taxation measures substantially interfered with such asset. Section two discusses the criteria used by international courts and tribunals in determining what amounts to a substantial interference with property rights to warrant payment of compensation by the state. It argues that in determining a compensable windfall taxation measure, aside from the nature of the property rights, an arbitral tribunal should take into account among other factors, the rate of the tax, any surprises sprung on the private investor, the existence or otherwise of any contractual commitments, the proportionality of the measure as well as any evidence of discrimination.

Law: a Victory Of Form over Life? A Crossroad Crossed?' *TDM* (June 2006); Z Elkins, A Guzman & B Simmons, 'Competing for Capital: The Diffusion of BITs' 1960-2000' (2006) 60 *Int'l. Org*. 811.

[9] R Dolzer & C Schreuer, *Principles of International Investment Law* (OUP, 2008) 9–11; R Dolzer, 'The Impact of International Investment Treaties on Domestic Administrative Law' (2005) 37 *N.Y.U. J. Int'l. & Pol*. 953; G van Harten & M Loughin, 'Investment Treaty Arbitration as Species of Global Administrative Law' (2006) 17 *EJIL* 121; B Simmons, 'International Law and State Behaviour: Commitment and Compliance in International Monetary Affairs' (2000) 98 *Am. Pol. Sc. Rev*. 819 at 819; cf J Yackee, 'Bilateral Investment Treaties, Credible Commitment, and the Rule of (International) Law: Do BITs Promote Foreign Direct Investment?' (2008) 42 *Law & Society* 805.

[10] S Schwebel, *The United States 2004 Model Bilateral Investment Treaty: An Exercise in the Regressive Development of International Law, in Global Reflections on International Law, Commerce and Dispute Resolution* (ICC Publishing 2005); R Happ & N Rubins, *Digest of ICSID Awards and Decisions 2003-2007* (OUP, 2009) 326; N Calamita, 'The British Bank Nationalisation: An International Law Perspective' (2009) 58 *ICLQ* 119, 135-136.

[11] On the significance of examining international investment law in its proper policy and political context, see P Muchlinski, 'Policy Issues' in P Muchlinski et al (ed) *The Oxford Handbook of International Investment Law* (OUP, 2008) 3 at 4-5 & 11.

II. The Notion of 'Protected' investment in the context of 'Windfall' Taxes

Two of the most important developments in modern investment treaties have been the expansion of the notion of protected 'investment' and direct right of action granted private foreign investors against host states for the alleged violation of any of the substantive treaty obligations assumed by the state. Many commentators have discussed what constitute protected 'investment' in the context of these treaties and the ICSID Convention, which we do not intend to repeat here.[12] What seems clear from the investment treaty practice, arbitral jurisprudence and the commentaries is that, 'investment' is given a broad and encompassing or functional definition as including any asset that has financial value for the holder, tangible or intangible such as shares, certain loans, profits, returns, contracts, interests arising from the commitment of capital or other resources, the expectation of gain or profit or the assumption of risk.[13] For as the tribunal in *Nagel v Czech Republic* observed,

> …when read in their context, the terms 'asset' and 'investment' in Article 1 shall be considered to refer to rights and claims which have financial value for the holder…However, a claim can normally have a financial value only if it appears to be well-founded or at the very least creates a legitimate expectation of performance in the future.[14]

According to one commentator, such broad and functional definition 'reflects a desire to encourage foreign investment in all its forms, *present and future'*, (emphasis in original).[15]

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[12] For a latest analysis of investment in the context of the ICSID Convention and its relationship with BITs see, the Annulment decision in *MHS v Malaysia*, award of 16 April, 2009, paras. 56-82. See also E Schlemmer, 'Investment, Investor, Nationality and Share holders' in Muchlinskin, et al (ed), supra (n. 4), 49; N Rubins, 'The Notion of 'Investment' in N Horn (ed), *Arbitrating Foreign Investment Disputes* (Kluwer, 2004) 292; M Hunter & B Barbuk, 'Reflections on the Definition of an "Investment"' in *Global Reflections on International Law, Commerce and Dispute Resolution* (ICC Publishing 2005) 381.

[13] eg Article 10.28 CAFTA-DR; Article 1 U.S. Model BIT (2004).

[14] SCC 49/2002 (2004), 1 Stockholm Arb. Rep. 145 at 158, available at:http://ita.law.univ.ca. *EnCana v Ecuador*, award of 30 December 2005, Partial and Dissenting Opinion of Horacio Grigera Naon, at para 14. For an analysis of the expansive concept of property under customary international law, see T Wälde & A Kolo, 'Environmental Regulation, Investment Protection and "Regulatory Taking" in International Law' (2001) 50 *ICLQ* 811; Jon A. Stanley, 'Keeping Big Brother out of our Backyard: Regulatory Takings as Defined in International Law and Compared to American Fifth Amendment Jurisprudence' (2001) 15 *Emory Int'l. Law Rev*. 349 at 356-360.

[15] B Legum, 'Defining Investment and Investor: Who is entitled to Claim?' (2005), available at http://www.oecd.org/investment; Muchlinski, supra (n. 11), at 19-20; P Ranjan, 'Definition of Investment in Bilateral Investment Treaties of South Asian Countries and Regulatory Discretion' (2009) 26 *J. Int'l. Arb*. 217, 226; S. Jarreau, 'Anatomy of a BIT: The U.S.-Honduras BIT' (2004) 35 *U. Miami Inter-Am. L. Rev*. 429. *Methanex v U.S*. award of 3 August, 2005, Part IV, Ch. D, para 17 (rejecting claim that market access and goodwill *Cont.*

In the context of windfall tax, assets that are of economic value for the private investor includes not only the profits and returns earned from the investment, but also the reasonable legitimate 'expectations of gain or profit' and enjoying same, especially those that would arise as result of increases in commodity prices, which have not been allocated to the host state through the investment contract or applicable legislation in existence at the time the investment is made or earning the profits. This is based on three conceptual arguments. Firstly, in any commercial undertaking, the legitimate expectations of earning a reasonable rate of return (taking into account the business and legieal environment in which the investor operates) and the right to benefit from the profits earned are 'fundamental' strands in the investor's bundle of proprietary rights, which should constitute a protected investment.[16] This is because these rights are necessary to the enjoyment of the underlying investment; oth-

constitute investment but affirming that the 'restrictive notion of property as a material 'thing' is obsolete and has ceded its place to a contemporary conception which includes managerial control over components of a process that is wealth producing.') *Pope & Talbot v Canada*, award of 26 June, 2000, paras. 96 & 98 (access to U.S. market is a protected investment); *Feldman v Mexico*, award of 16 December, 2002, para 96 (noting 'the term investment is defined in [NAFTA] art. 1139 in exceedingly broad terms. It covers every type of financial interest, direct or indirect, except certain claim to money.') It might be argued that the rejection of market access and good will as constituting investment by the Methanex Tribunal on the ground that they have not been included in the illustrative list in article 1139 does not conform with the broad and functional definition alluded to above nor takes into account present and future developments in the economic value of market access and good will nor the evolving conception of proprietary rights. For as Sidak and Spulber have argued (in the context of U.S. takings law), government deregulation of a hitherto regulated utilities industry that resulted in substantial diminution of the incumbents' market share and profitability ('reasonable investment-backed expectations') should amount to a compensable taking. J Sidak & D Spulber, 'Deregulator Takings and Breach of the Regulatory Contract' (1996) 71 *N.Y.U.L. Rev*. 851; J Sidak & D Spulber, 'Givings, Takings, and the Fallacy of Forward-Looking Costs' (1997) 72 *N.Y.U.L. Rev*. 1068; cf O Williamson, 'Deregulatory Takings and Breach of the Regulatory Contract: Some Precautions' (1996) 71 *N.Y.U.L. Rev*. 1007; S. Rose-Ackerman & J. Rossi, 'Disentangling Deregulatory Takings' (2000) 86 *Va. L. Rev*. 1435.

[16] See *Beyeler v Italy*, decision of 5 January 2000, ECtHR, para. 100 where the Court stated that possession includes '.. either "existing possessions" or assets, including claims, in respect of which the applicant can argue that he or she has at least a "legitimate expectation" of obtaining effective enjoyment of a property right'. In the business community, the right to earn profits has traditionally been considered one of the most treasured strands in an owner's bundle of property rights. The issue of whether an interference with certain strands in the bundle of the owner's property rights is severable from the whole bundle for purposes of takings under the U.S. constitution has bee addressed by the U.S. Supreme Court in a number of cases, but the legal position still remain unclear due to the conflicting decisions. Nonetheless, some of the decisions affirmed the principle under certain circumstances, such as in where the 'expectancies' or rights are 'sufficiently important,' or can be considered 'the most treasured strands in an owner's bundle of property rights.' eg see *Kaiser Aetna v U.S.*, 444 U.S. 164 (1979) at 179; *Loretto v Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982) at 435; cf. *Penn Central Transp. Co. v New York City* 438 U.S. 104 (1978) at 130-31; *Keystone Bituminous Coal Ass'n. v DeBenedicts* 480 U.S. 470 (1987) at 498; D Wright, 'A New Time for Denominators: Towards a Dynamic Theory of Property in the Regulatory Takings Relevant Parcel Analysis' (2004) 34 *Envt'l. L.* 175; C Massey, 'Takings and Progressive Taxation' (1996) 20 *Harv. J. L. & Pub. Pol'y*. 85.

erwise, no risk-averse investor would invest his time, energy and capital into any commercial venture. Their significance is attested to by the fact that they add to the stock value of the enterprise and the company's credit worthiness. Thus, '[w]ithout property protection of returns to equity, investors ... would have a reduced incentive to invest in stock, which would significantly complicate the raising of funds through financial markets'.[17] For as arbitrator Naon noted whilst interpreting the term 'investment' under the applicable BIT in *EnCana v Ecuador*:

> Tax refunds are assets in the sense of 'any kind of asset', 'claims to money having a financial value' listed under the definition of investment in article 1(g) of the Treaty and have been properly recorded as receivables in the books of EnCana's subsidiaries.
>
> ... [S]uch receivables have a market value, i.e. are quoted in the market and may be traded at a small discount. Such assets may be used '…for the purpose of economic benefit'… since by improving the cash flow situation of the subsidiary, it enhances its economic health and the returns of the sole shareholder ... Returns, as defined in the Treaty, include profits and dividends ... and are expressly subject to its expropriation provision...[18]

Earlier in the award, arbitrator Naon observed as follows:

> The foreign investor's legitimate return expectations are inextricably linked to the foreign investor's entitlement under the Treaty to its investment. ... Thus, the foreign investor's return entitlement protected by the Treaty is not limited to returns already accrued and extends to the legitimate investor's expectations through-out its investment's life and embodied in the very notion of returns.[19]

Although the majority of the tribunal in the *EnCana* case did acknowledge the proposition that a right to tax refunds may constitute a separate protected investment under the BIT, nonetheless it was of the opinion that such a right only arises if the domestic law of the host state provided for it and that it applies only with respect to transactions conducted under such a law but not to future transactions when that law is no longer in effect.[20] In other words, the major difference between the majority and

[17] Sidak & Spulber (1996), supra (n. 15), 935–36. This fact has also been recognised by the tribunal in *Sergei v Mongolia* as one of the negative effects of the disputed tax, which it considered as one of the reasons for granting the interim measures enjoining the forced collection of the said tax. Paras. 61 & 77. The right to receive profits in the form of dividends paid has been recognized by the American Overseas Private Insurance Corporation as one of the investor's 'fundamental rights' the denial of it by the host state might constitute expropriation under the Corporation's contract of insurance. See V Koven, 'Expropriation and the "Jurisprudence" of OPIC' (1981) 22 *Harv. Int'l. L. J.* 269, 298-303.

[18] *EnCana v Ecuador*, award of 30 December 2005 (Partial Dissenting Opinion of Horacio Naon), paras 70-71.

[19] ibid, para 17.

[20] Award of 3 February, 2006, paras. 183 &184.

the dissent is that while the majority held that 'for there to have been an expropriation of an investment or return (in a situation involving legal rights or claims as distinct from the seizure of physical assets) the rights affected must exist under the law which creates them',[21] the dissent held that the foreign investor's legitimate return expectations constitute an interest or ownership rights 'directly protected by the Treaty and is not premised on the national law of the host state once the investment, that comprises the right to obtain returns on the investment, has been made in accordance with the laws and regulations of the host state'.[22]

In the context of taxation and protection of private proprietary rights generally, the dissenting opinion of arbitrator Naon is probably more persuasive than that of the majority. For as we mentioned above, one of the purposes of investment treaties was to help create a stable legal framework for foreign investment by constraining opportunistic government actions. Such objective would be defeated if the enjoyment of such protected rights under the treaty were made subject to the vagaries of the domestic laws of the host state, which might be changed at any time.[23] Furthermore, several tribunals including the European Court of Human Rights (ECtHR) have held that the private investor's reasonable legitimate expectations are an integral part of its proprietary rights the frustration of which may constitute a compensable expropriation.[24] This principle is grounded in the notion of good faith and detrimental reliance, and the principle of legal certainty, which is an important aspect of rule of law.[25] The concept of legitimate expectations is part of the legal

[21] ibid para 184.

[22] Partial and Dissenting Opinion, supra at paras. 17 & 20

[23] Under international law, an acquired or vested right survives not only a change in the host state laws but even the extinction of the state as a result of state succession rules. For as the tribunal in *Phoenix Actions, Ltd v Czech Republic* noted: 'The state is not at liberty to modify the scope of its obligations under the international treaties on the protection of foreign investments, by simply modifying its legislation or the scope of what it qualifies as an investment that complies with its own laws.' Award of 15 April, 2009, para 104. See also *German Settlers* Case (*Germany v Poland*), Advisory Opinion of 10th February, 1923, P.C.I.J. Ser. B, No. 6 (1923) at 36, cited in, Reinisch (2008), supra, at FN. 24; C McLachlan, L Shore & M Weiniger, *International Investment Arbitration: Substantive Principles* (OUP, 2007) 181–184; cf Happ & Rubins, supra (n. 10), 334 (noting, '[t]ribunals have therefore considered it necessary to determine such issues as whether an asset exist, whether the asset has any economic value and what it consists of as a matter of local law before assessing whether the state's actions have affected the asset in question') (footnotes omitted).

[24] eg *Pope & Talbot . Canada*, award of 26 June, 2000, para 96; *Metalclad v Mexico*, award of 30 August, 2000, para 103; *LG & E v Argentina*, award of 3 October, 2006, para 190; A Walter, 'The Investor's Expectations in International Investment Arbitration' in A Reinisch & C Knahr (eds), *International Investment Law in Context* (2008) 172 at 178-182, also available from *TDM* (2009).

[25] C Brown, 'The Protection of Legitimate Expectations as a "General Principle of Law": Some Preliminary Thoughts' (2009) 6(1) *TDM*; F Vicuna, 'Regulatory Authority and Legitimate Expectations: Balancing the Rights of the State and the Individual under International Law in a Global Society' (2003) 5 *Int'l. L. FORUM D. Int'l.* 188.

order established by modern investment treaties and it is applicable to tax matters to the extent that taxation measures are subject to any of the treaty disciplines, especially the expropriation provision. As we noted elsewhere, the rationale for applying the concept of legitimate expectations to tax matters is to 'prevent host states from springing surprises on unwary or unsuspecting foreign investors and curb possible abuse of tax legislation (especially through reinterpretation and rulings by tax authorities) in a manner that would adversely affect the economic interests of foreign investors'.[26]

Hence, the recognition and application of the concept by international tribunals, as an integral part of the private investor's property rights, or at least, to define the scope of the right. For instance, in *M.A. v Finland*, while it rejected the applicants' claim that the disputed tax unreasonably interfered with their legitimate expectations of a lower tax rate (which constitute an asset and possession under Article 1 of Protocol 1 of the European Convention on Human Rights (ECHR)), the ECtHR did not rule out such a possibility.[27] This decision is in accord with the court's frame of analysis of article 1 protocol 1, under which it views property in economic terms – as wealth or the economic value of the subject matter being regulated.[28]

Secondly, the term 'windfall' is used to describe extraordinary and unexpected profits,[29] or the fruits of chance and luck.[30] However, it has

[26] Wälde & Kolo, supra (n. 4) at 355-56.

[27] Application no. 277793/95, ECHR Judgment of 10 June, 2003 at pp. 11-12. According to the Court: 'In this respect, the Court considers that the applicants did not have an expectation protected by Article 1 Protocol No I that the tax rate would, at the time when they would have been able to draw benefits from the stock option programme, ie between 1 December 1998 and 31 January 2000, be the same as it was in 1994 when the applicants subscribed the bonds. The court does not exclude that the situation might have to be assessed differently had the law applied (which it did not) even to cases in which the exercise of the stock options was possible before 1 January 1995 according to the relevant terms and conditions of the stock option programme in question. In such a situation, in which the applicants did not find themselves, taxation at a considerably higher tax rate than that in force on the date of the exercise of the stock options could arguably be regarded as an unreasonable interference with expectations protected by Article 1 of Protocol No. I'. See also *Kopecky v Slovakia*, Appl. No. 44912/98, judgment of 28 September, 2004, para 47; Pine Valley *v* Ireland, Appl. No. 1274/87, judgment of 29 November 1991, para 51 (noting that legitimate expectation was 'a component part of the applicant companies' property'); P Baker, *Retrospective Tax Legislation and the European Convention on Human Rights*, BTR (2005) 1; P Poopelier, 'Legitimate Expectations and the Law maker in the Case Law of the ECHR' (2006) 1 *E.H.R.L.Rev.* 10. ; L Wildhaber & I Wildhaber, 'Recent Case Law on the Protection of Property in the European Convention on Human Rights, in C Binder, U. Kriebaum, A Reinisch & S. Wittich (eds), *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (OUP, 2009) 657.

[28] T Allen, 'Compensation for Property under the European Convention on Human Rights' (2007) 28 *Mich. J. Int'l. L.* 287, 313-320; Poopelier, ibid.

[29] E Kades, Windfalls, 108 *Yale L.J.* (1999) 1489, at fn 2 citing the *Oxford English Dictionary* (2d ed. 1989) 378. Prof. Kades has defined it as 'economic gains independent of work, *Cont.*

been argued that profits derived by an oil or mining company as a result of increases in prices cannot be regarded as 'fruits of chance or luck' nor as 'unexpected' but rather as earned rents or rewards for the risks undertaken in the investment of capital and other factors of production.[31] Therefore, such profits should not conceptually, be classified as windfall for purposes of taxation because, 'an overly broad definition of 'windfalls' will lead society to take not only surprise income, but also income resulting from effort and enterprise. This outcome would create serious disincentives to create wealth'.[32] Furthermore, since the first oil shock of 1970s, dramatic increases (and fall) in oil prices has become a common (if not inevitable) phenomenon, which is factored in the investment decision-making process of private investors and mineral producing countries. Consequently, the surprise element used to justify windfall taxes in the 1960s and 1970s no longer applies. For as Professor Kades rightly observed,

> The windfall justification for special taxation, however, only works once. The world oil markets did seem largely surprised by OPEC's successful cartelisation in 1973. Few if any investment and exploration decisions contemplated skyrocketing oil prices. Since the first oil shock, however, OPEC has remained a fundamental source of risk in the oil market. … OPEC is now part of the oil market landscape, and it is positively desirable that oil producer weigh the cartel's effects in their exploration and investment decisions.[33]

Indeed, since the 1970s 'oil shock', most oil and other minerals producing countries have restructured their natural resources sector and refined their tax policies so as to capture the economic rents more effectively despite the uncertainty about future production costs and prices. Many minerals producing countries adopted state participation and introduced the resource rent tax in the 1970s well before similar taxes were adopted by the industrialised countries.[34] Hence, any argument

planning, or other productive activities that society wishes to reward.' ibid. 1491.

[30] T Adams, 'Should the Excess Profits Tax be Repealed?' (1921) 35 *Q. J. Econ*. 363, 367.

[31] For as Kades puts it: Not all rents are windfalls. An oil company that engages in calculated risks and discovers a field yielding oil at a cost far below market price will reap rents, but they are *earned* rents, and hence they are not windfall' (emphasis in original). Supra (n. 29) at 1496.

[32] ibid, at 1499.

[33] ibid, at 1550.

[34] Gillis, supra (n. 7); R Garnaut & A Ross, 'Uncertainty, Risk Aversion and the Taxing of Natural Resource Projects' (1975) *Econ. J*. 272; J Otto, M Batarseh & J Cordes, *Global Mining Taxation: A Comparative Study* (2000) at 22-23; S Kobrin, 'Environmental Change, Industry Structure and Corporate Strategy: the Nationalisation of Oil Production' (1984/85) 9 *OGLTR* 239. However, the history of excess profit tax goes back to the First World War when Sweden, followed by Denmark and subsequently other countries, imposed war profits taxes. See, C Plehn, 'War Profits and Excess Profits Taxes' (1920) 10 *Am. Econ. Rev*. 283; Adams (1921), supra (n. 30), Idem, 'Federal Taxes upon Income and Excess Profits' (1918) 8 *Am. Econ. Rev*. 18; R Haig, 'British Experience with Excess Profits Taxation' (1920) 10 *Am. Econ. Rev*. 1; Kades, supra (n. 29) at 1538-1552.

about unforeseen increase in prices as justification for ex post imposition of 'windfall' taxes on private investors would seem less persuasive than the counter argument that such price increases are a matter of life or common knowledge and ought to be taken into account by producing countries when negotiating their natural resources development agreements with foreign investors. So also is the related argument that since the society owns the natural resources, it (rather than the private investor) should benefit from any increase in prices. This ignores the counter argument that it was the private investor that bore the initial risks in exploration and development of the natural resources, which otherwise, might remain underground and therefore of no immediate benefit to the society.[35] As such, the private investor should also be compensated relative to the risks undertaken.

Finally, contract is a means of risk allocation between the parties. In negotiating an oil and gas or mining development agreement, the parties normally factor into their deal the possibility of future changes in prices as well as the probable amount of the discovery, and allocate the rent between themselves accordingly, taking into account the applicable tax and regulatory regime. In such a situation, it might be argued that '[t]here is then no windfall, but merely reward commensurate with the risk taken'.[36] An ex post unilateral adjustments to the terms of the deal by the host state would not only upset the contractually allocated risks and create uncertainty but it would also result in a windfall in favour of the government.[37] This is more so if the host government gave assurances (through legislation or contractual device) of non-unilateral adjustment in the terms of the investment agreement.

In view of the above analysis, it might be argued that, taxing away a substantial part of the 'windfall' profits of a foreign investor and

[35] The premise that oil companies obtained acreage on the cheap in the 1990s and should therefore be subject to windfall taxes is deficient. The concessions were not just a gratuitous government gifts. They were granted on those terms because of the then prevailing and justified belief that exploration and development of the natural resources was essential to the host state's well-being and its development. On the companies' part, they received the concessions on those terms because they were taking great risks and the host states wanted them to succeed. Yet, those risks are easily forgotten once discoveries are made. T Wälde & A Kolo, 'Renegotiating Previous Governments' Privatisation Deals: The 1997 UK Windfall Tax on Utilities and International Law' (1999) 19 *NW. J. Int'l. L. & Bus*. 405, 406; G Kanner, 'Making Laws and Sausages: A Quarter-Century Retrospective on *Penn Central Transportation Co. v City of New York*' (2005) 13 *Wm. & Mary Bill Rts. J.* 679, 752-753.

[36] Kades, supra (n.29) at 1502.

[37] ibid, at 1511 (noting: 'People often arrange their contracts and other affairs with one eye on the legal environment in which they live. When courts [and tribunals] lose sight of this sort of planning, they erroneously label as windfalls gains earned by prudent planning. Such holdings … undermine incentives to engage in the eminently productive activity of planning one's affairs in compliance with the law'). See also Garnaut & Ross, supra (n. 34); Sidak & Spulber (1997) supra (n. 15) at 1976-1078.

frustration of its legitimate expectations of benefiting from such profits may amount to a compensable taking of protected investment even though the underlying investment remain intake. This is especially so if the windfall tax is retrospective, in breach of contractual commitments, disproportionate and/or discriminatory.

In the next section, we shall briefly discuss some of these criteria.

III. Other Criteria for Determining Confiscatory 'Windfall' Taxes

A. Breach of Contractual Commitment

Investment in the exploration and development of natural resources is a capital intensive, long term and high risk commercial activity. Normally, the decision on whether or not to invest in a particular project is made based upon a risk-reward analysis taking into account several variables or factors such as cash flows, costs, forecast of prices, geological risk, political risk and the regulatory regime. Although these assessments are never precise, but based on probabilities, nevertheless, the taxation policies of the host state have significant impact on these factors.[38] As such, if the foreign investor decides to invest, it expects a reasonable level of stability in the tax and regulatory regime. It has a legitimate expectation that the domestic law is not deployed in an abusive or arbitrary way against it and not in a way that is utterly unpredictable and cannot reasonably be foreseen when the investment is undertaken.[39] This is more compelling in a situation in which the host government has given the foreign investor assurances of tax stability ie, an assurance not to alter the tax law or its interpretation to the detriment of the foreign investor, which representation induced the investor to make the investment. Such assurances would bind the host state regardless of whether or not the assurances may be inconsistent with domestic law.[40] This proposition is also supported by the decision

[38] Otto, et al, supra (n. 34) 6; S. Tordo, 'Fiscal Systems for Hydrocarbons: Design Issues, World Bank' WP No. 123 (2007), available at: http://www.worldbank.org/external/default/WDSContentServer/WDSP/IB/2007/09/19/000020953_20070919144359; Nakhle, supra (n. 2) at 3.

[39] For as the ECJ stated in *OPEL Austria v Commission* (in the context of the EU Law, but also under customary international law) '[the] requirement of legal certainty must be observed all the more strictly in the case of a measure liable to have financial consequences in order that those concerned may know precisely the extent of the obligations which it imposes on them.' Case T-115/94, Judgment of 22 January, 1997, para 124, available at:http://eur-lex.europa.eu/ ; Nakhle, supra (n. 2) at 13-14.

[40] *SPP v Egypt*, 8 ICSID Rev.-FILJ (1993) 328; W. Reisman & M. Arsanjani, 'The Question of Unilateral Governmental Statements as Applicable Law in Investment Disputes' 19 *ICSID Rev.-FILJ* (2004) 328; M. Salias, 'Do Umbrella Clauses apply to Unilateral Undertakings?' in C. Binder, et al (eds), supra (n. 27) 490; T Wälde & A Kolo, 'Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law' (2001) 50 *ICLQ* 811, *Cont.*

in *Duke v Peru*, in which one of the central questions was whether the government breached its obligation of good faith implied in the Legal Stabilisation Agreement it entered into with the claimant. In 2001, the tax authorities assessed a tax liability of over $47million against the claimant, back-dated to 1996, on the ground that the 1996 merger (under a 1994 Merger Revaluation Law) between Egenor (claimant's predecessor) and another company was a sham concluded to avoid the payment of taxes. The claimant argued that the 2000 tax assessment was contrary to the prior conduct and representations of other organs and entities of the Peruvian government (such as Electroperu, the state's shareholder of the joint venture companies it had with the claimant, the privatisation agency etc) with whom it dealt. On the other hand, the respondent contended that a 'sophisticated investor such as claimant cannot claim to be unfamiliar with the well recognised principle that a national tax service cannot be bound by the actions of a separate governmental entity' (para. 374). The tribunal held that: 'In international law, it is possible for entities and agencies other than the national tax service to bind the state to a particular position concerning transactions with tax implications' (para. 432) However, the tribunal stated that this is possible only if the representation is that of a competent state entity or official that 'may reasonably induce reliance in third parties' (para. 433). Based on this legal principle and the facts of the instant case, the tribunal concluded that the actions of other agencies of the Peruvian state bind the tax authorities even if the agencies lacked such a power under domestic law.[41]

Aside from the principle of good faith and respect for legitimate expectations,[42] the binding nature of governmental assurances of tax stability can also be defended on efficiency grounds. Otherwise, private investors would demand high risk premium when negotiating with such

843-45; T Nocker & G. French, 'Estoppel: What's the Government's Word Worth: An Analysis of German Law, Common Law Jurisdictions, and of the Practice of International Arbitral Tribunals' (1990) 24 *Int'l. Law*. 409, 433-437. For an analysis of the concept and legal effect of stabilisation clauses and their interaction with the concept of sovereignty, see AF Maniruzzaman, 'The Pursuit of Stability in International Energy Investment Contracts: A Critical Appriasal of the Emerging Trends' (2008) 1:2 *J. W.E.L. & Bus*. 121; L. Cotula, 'Reconciling Regulatory stability and Evolution of Environmental Standards in Investment Contracts: Towards a Rethink of Stabilisation Clauses' (2008) 1:2 *J.W.E.L. & Bus*. 158.

[41] According to the tribunal, 'from the point of view of the reasonable investor, the actions and representations of the representatives of Electroperu and of the various state agencies involved in the privatisation of Egenor created confidence in the investor that the state would not reverse course after the merger was approved and consummated.' *Duke v Peru*, award of 18 August, 2008, para 436. See also *Revere Copper & Brass, Inc. v OPIC*, award of 24 August 1978, 17 *ILM* (1978) 1321 at 1331.

[42] Ch Brown, supra (n. 25); Vicuna, supra (n. 25); D Vielleville & B Vasani, Sovereignty over Natural Resources versus Rights under Investment Contracts: Which One Prevail? 5(2) TDM (2008).

governments as compensation for the legal uncertainty with respect to the government's contractual commitments.[43] However, this is not to suggest that the existence of such commitments would preclude the host government from changing its tax regulations applicable to the investment. Rather, such changes should take place in a transparent manner (ie, by giving reasonable notice to those to be affected) or through bilateral negotiations with the affected economic operators failing which the dispute settlement provision of the investment agreement might be invoked by either party with a view to resolving the dispute through binding decision. On the other hand, in the absence of such contractual commitment, it is perfectly within the fiscal sovereignty of the host state to adapt its tax regulations to meet changing political, economic and social conditions[44] provided the measures are proportionate to the public good sought to be achieved.

To sum up, contractual commitment is one of the criteria used by international tribunals in the determination of whether or not taxation measures amounted to expropriation.

B. Intensity of the Tax Measures

As with domestic constitutional laws on the protection of private property against appropriation by the state,[45] the main purposes of the expropriation provisions of modern investment treaties include the need to curb opportunistic behaviour by the state parties and to ensure that it is the general public, rather than the private investor, that pays for the public good derived from regulating private property in the public interest.[46] Thus, the underlying rationale of the law on expropriation is to strike a balance between the right to private property and the public interest. Hence, several tribunals have held that, an interference with

[43] Sidak & Spulber (1997), supra (n. 15) 1151; D Goldberg, 'Government Precommitment to Tax Incentive Subsidies: The Impact of *United states v Winstar Corp*. on Retroactive Tax Legislation' (1997) 14 *Am. J. Tax Pol'y*. 1 at 6-8.

[44] *Encana v Ecuador* (majority opinión), supra, para 173; *Feldman v Mexico*, award of 16 December, 2002, para 103; *Methanex v U.S.A.*, award of 7 August, 2005, Part IV, Ch, D, Para. 10; *Parkerings v Lithuania*, award of 11 September, 2007, paras.332-333; Nakhle, supra (n. 2) 15.

[45] G Starner, 'Taking a Constitutional Look: NAFTA Chapter 11 as an Extension of Member States' Constitutional Protection of Property' (2002) 33 *Law & Pol'y. Int'l. Bus*. 405; cf. V Been & J Beauvais, 'The Global Fifth Amendment? NAFTA's Investment Protections and the Misguided Quest for an International 'Regulatory Takings' Doctrine' (2003) 78 *N.Y.U.L. Rev*. 30, 87-108.

[46] eg according to the U.S. Supreme Court, the main purpose of the takings law was to 'bar government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole'. *Nollan v California Coastal Commission*, 483 US 825 at 835, note 4 (1987), quoting *Armstrong v US*, 364 US 40 at 49. See also, L Kaplow & S Shavell, 'Economic Analysis of Law' in A Auerbach & M Feldstein (eds), *Handbook of Public Economics* Vol. 3 (2002) 1661, 1689; cf Ackerman & Ross, supra (n. 15), 1481-1483.

private proprietary interests becomes compensable if it *substantially deprives* the alien of her property rights and that the severity of the economic impact is the decisive criterion.[47] In determining what is substantial deprivation, most arbitral tribunals have used the entire investment as a unit or as the 'denominator' and the impact of the regulatory measures on the unit rather than on a particular segment or strand of the underlying investment, such as the profitability.[48] For instance, in *Feldman v Mexico*, whilst acknowledging that the impugned measures effectively deprived the claimant of his ability to export cigarettes and derive profits there from, nonetheless, the tribunal held that although the measures may have frustrated the most profitable use of his exportation business, it did not deprive him of control of the investment nor displaced him as the controlling shareholder.[49] Similarly, in *Archer Daniels v Mexico*, the respondent argued that 'the substantial deprivation test under article 1110 [NAFTA] cannot be considered in the abstract and applied to the claimants' sales of HFCS – calculated in the form of lost profits – as these do not constitute an investment under the treaty' (para. 236). In accepting the respondent's contention the tribunal held that 'the test for expropriation under Article 1110 cannot be considered in the abstract or based exclusively on the Claimants' loss of profits, which is not necessarily a sufficient sole criterion for an expropriation'.[50] On the other hand, in rejecting the claimants' claim, the tribunal held that 'only loss of control over the investment or substantial loss of its economic value may amount to an indirect expropriation' (para. 242). Applying this test to the facts of the case, the tribunal concluded that the 'tax did not deprive the Claimants of fundamental rights of ownership or management of their investment. The claimants have remained in full title and possession of their investment, controlling at all times ALMEX's production, sales and distribution of its products'.[51]

[47] *Glamis Gold Ltd v USA* award of 8 June 2009, paras 356-358; *Archer Daniels v Mexico*, award of 21 November, 2007, para 240; *Pope & Talbot*, supra, para 102; *S.D. Myers v Canada*, award of 13 November 2000, para 282; A Reinisch, 'Expropriation' in Muchlinski, et al (2008), supra (n. 4) 407, 438-442; S Ratner, 'Regulatory Takings in International Context: Beyond the Fear of fragmented International Law' (2008) 102 *AJIL* 475; Happ & Rubins, supra (n. 10) 349.

[48] *Glamis Gold Ltd v USA*, award of 8 June 2009, paras 534-536; Ratner, ibid at 482. Similarly, in the context of the ECHR, according to Schreuer and Kriebaum, 'fora deprivation in the sense of the second sentence of paragraph 1 to occur there must be a deprivation of the whole bundle of rights. If only some of the rights are taken, the Court will examine the case either under the second paragraph (control of the use of property) or under the first sentence of the first paragraph of Art. 1 (peaceful enjoyment of possession))'. See, C. Schreuer & U. Kriebaum, 'The Concept of Property in Human Rights Law and International Investment Law', in S. Brieitenmoser, B. Ehrenzeller, M. Sassoli, W. Stoffel & B. Pfeiffer (eds), *Human Rights, Democracy and the Rule of Law. Liber Amicorum Luzius Wildhaber* (2007) 743 at 759-60.

[49] para 152; *Occidental v Ecuador*, award of 1 July, 2004, paras 88 & 89; *Pope & Talbot*, supra, para 100

[50] para 248.

[51] para 245.

These decisions seem to suggest that 'substantial' diminution in value of the investment as a unit is not sufficient to amount to expropriation unless the diminution is close to 100 percent.[52]

In our opinion, the test should be different when one is dealing with 'windfall' profits taxes, which target and impact on a specific strand of the investment ie, the profit margin over and above a set contractual price or benchmark. For instance, in *Sergei Paushok v Mongolia*, the disputed law set the windfall profits tax at 68% on gold sales at prices in excess of US$500 per ounce ie, that part of the profits/revenue derived when prices exceed the US$500 benchmark is taxed at 68%.[53] Such taxes do not target the underlying investment but rather they are aimed at taxing away specific revenue streams that are considered by the host states as 'excessive' or 'fat cats' worthy of skinning. In such situations, one might argue that, it is economically sensible and legally plausible to consider such revenue streams and the legitimate expectations of enjoying same by the foreign investor as separately protected proprietary rights under the expropriation provisions of the applicable investment treaty.

Although the tribunal in the *EnCana* case affirmed that the tax refunds were 'claims to money', which the BIT recognises as a protected investment, nonetheless it held that the effect of the legislative change on EnCana's subsidiaries was not substantial since they continued to function profitably and to engage in the normal range of activities.[54] Instead, such expropriation occurs only if a tax law is extraordinarily punitive in amount or arbitrary in its incidence.[55]

In the context of 'windfall' tax, if our above analysis (to the effect that the profits or returns together with the legitimate expectation of deriving and enjoying same constitute a separate proprietary right) is correct, then a host state cannot lawfully tax it to such a level that the right is effectively taken away because if that were allowable under the applicable BIT, the very essence of the protection granted to profits or returns by the treaty would be set at naught. As we stated earlier, support for this proposition can be found in the dissenting opinion of arbitrator Naon in the *EnCana* case as well as the decision of the ECtHR in the *M.A. v Finland* to the effect that the legitimate expectations of a lower tax rate constituted an asset or possession under Article 1 of Protocol 1 of the Convention. However in this case, the court held that the impact of the disputed tax measure 'was not such as to amount to confiscatory taxation or of

[52] Happ & Rubins, supra (n. 10) 351.
[53] *Sergei Paushok v Mongolia*, supra, para 5. In *Cite Oriente v Ecuador*, supra, the claimant alleged that the Ecuadorian government raised the windfall profit tax to 99% from 50% under Law 42 enacted by the previous government.
[54] para 174
[55] para 177

such a nature as could deprive the legislation of its character as a tax law. Despite its important financial consequences for the applicants, the measure cannot be said to have imposed an excessive burden on them, taking into account the maximum percentage of the tax levy and the fact that the levy, which in part was a reflection of the very high general income level of the applicants, was based on real profits made from the sale of the stock options'.[56]

This decision suggests that a substantial deprivation (through taxation) of the profits earned and/or the legitimate expectation of deriving and enjoying same may amount to expropriation. What amounts to 'substantial' deprivation would depend on the circumstances of each case taking into account such factors as: the rate of the tax, the history of the investment (eg whether or not the investor has recouped its investment). By way of analogy, one might argue that a windfall tax on profits could be considered excessive and expropriatory if it exceeds the highest rate of income tax applicable in the host state or based on a comparative tax law of 'good' and 'normal' tax practice in developed system of law.[57] This is because the highest income tax rate might be considered fair and reasonable in such a society and therefore should not be regarded as excessive on the investor as other economic operators might also be subject to same tax rate. Thus, a foreign investor who invests in a high tax jurisdiction should expect to pay higher taxes in the absence of explicit or implicit commitment to the contrary by the host state.

C. Proportionality

In the *Archer Daniels* case, the tribunal observed that in addition to the intensity of the measure, other factors which might be taken into account include whether the measure was proportionate.[58] Other tribunals, including the ECtHR, have used this criterion in their decisions as to whether or not a regulatory measure amounts to expropriation. According to the case law of the ECtHR, an interference with property rights 'including one resulting from a measure to secure the payment of taxes, must strike a 'fair balance' between the demands of the general interests of the community and the requirements of the individual's fundamental rights … there must be a reasonable relationship of proportionality between the means employed and the aims pursued'.[59] However, in determining whether or not the requirement of proportionality has been met with respect to tax legislation, the court

[56] pp 12-13.
[57] Wälde & Kolo, supra (n. 4) at 442-443.
[58] para 250
[59] *M.A. v Finland*, supra at p. 11

provide a wide margin of appreciation to the states and tends to 'respect the legislature's assessment in such matters unless it is devoid of reasonable foundation'.[60] Among the factors taken into account by the court in deciding whether the criterion has been met include: whether the legislation was considered necessary from the angle of fiscal policy and the impact of the legislation on the position of the private individual.[61]

The proportionality test has also been adopted by some arbitral tribunals. For example, in *TECMED v Mexico*, the tribunal stated that:

> … in addition to the negative financial impact of such actions or measures, the Arbitral tribunal will consider, in order to determine if they are to be characterised as expropriatory, whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding proportionality.

There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realised by any expropriatory measure'.[62]

It concluded that in this case, effect of the measure was disproportionate to the government's objectives.

In the context of windfall tax, it might be argued that, although host governments enjoy wide margin of appreciation in deciding if the tax should be imposed on foreign investors and at what rate, nevertheless an international tribunal should have the jurisdiction to inquire into whether the taxation measure is reasonable and proportionate in the circumstances of each case, taking into account the steps taken by the host state to induce the investor to invest in the country, the amount invested and its duration, and whether or not the investor has recouped

[60] ibid (citing *National Provincial Building Society v UK*, judgement of 23 October, 1997, paras. 80-82).

[61] ibid On the tax jurisprudence of the court, see Wälde & Kolo, supra (n. 35) 411-415. For instance, in *Mamidakis v Greece*, No. 35533/04, decision of 11 January 2007, the first section of the European Court found that a fine of about 3 million Euros imposed on the claimant and another one of about 5 million Euros imposed on him jointly with other persons by the Greek authorities for smuggling oil was disproportionate relative to the aim sought to be achieved. According to the Court, '... even taking into account the margin of appreciation enjoyed by Contracting States in such matters, ... the imposition of the fine in question had dealt such a blow to the applicant's financial situation that it amounted to a disproportionate measure in relation to the legitimate aim pursued'. Para 48 (quoted by Wildhaber & Wildhaber, supra (n. 27) at 673. This suggests that even a fine for criminal conduct might amount to deprivation of property; what more if it were a tax levied on a legitimate earning of the individual concerned?

[62] Award of 29 May, 2003, para 122; *Azurix v Argentina*, award of 14 July, 2006.

its initial capital invested in the project, the reasonable rate of return expected by foreign investor at the time it made the investment and its reasonable expectations with regard to probable changes in the tax regime as well as the underlying rationale of the tax ie, whether it is aimed at driving the investor out of business.[63]

D. Discrimination

Discrimination against the foreign investor is another factor which international tribunals take into account in determining whether or not a disputed host state measure amounted to expropriation. In the *Feldman*, *Occidental* and *Archer Daniel* cases, evidence of discrimination were found to exist in the tax measures adopted by the respective respondents but that fact alone, did not qualify the measures as expropriatory. However, it was taken into account by the tribunals in their calculation of the damages awarded to the respective claimants. Thus, although evidence of discrimination might support a finding of confiscatory taxation, nonetheless, it is a less significant or subsidiary element.[64]

IV. Policy Implications of 'Windfall' Taxes on the natural resources Industry

Opinion is sharply divided on the merits and demerits of windfall taxes generally and on the oil and gas and mining companies in particular. The populist view championed by tax authorities and some commentators posits that, such taxes are justified because they provide an important source of revenues to the producing countries and ensure that the countries benefit from the exploitation of their natural resources, which in most cases, represent the main or major source of revenue for the treasury. This would enable the governments to increase investment in education, health and other social sectors,[65] more so as such taxes

[63] For instance, in the widely discussed Yukos case, it is perceived by numerous commentators, including the European Parliamentary Assembly Special Rapporteur, Sabine Luethensser-Schnarrenberger, that the underlying reason for pursuing the company was to legally drive the company into bankruptcy and take it over at a fraction of its original value. See Thomas Wälde's Expert Opinion in *Yukos v Russian Federation*, available from 2:3 *TDM* (2005). For a discussion of the relevance of proportionality in determining an expropriation action, see Reinisch, supra (n. 47) 449-450; Wälde & Kolo, supra (n. 40) 827-835.

[64] Reinisch, supra (n. 47) 450-451; Wälde & Kolo, supra (n. 40) 835-837; Wälde & Kolo, supra (n.35) 413-414; Stanley, supra (n. 14) 377-380.

[65] The 1997 UK windfall tax on utilities was defended by the then government on the basis of its welfare-enhancing objectives. See Lucy Chennells, 'The Windfall Tax' 18 *Fiscal studies* (1997) 279; L Miles, 'Fat Cats and Windfall tax: Should Companies Consider the Greater good?' (1998) 19 *Comp. Law*. 70. A similar welfare-enhancing argument has been made in support of calls by some politicians for the imposition of windfall tax on energy *Cont.*

are normally imposed on 'unanticipated' revenues earned by the companies. Some have argued that the tax is efficient as it is a non-distortionary source of revenue. 'Taxing unearned income does not undermine incentives for effort and enterprise; taxing surprises cannot distort agents' economic planning', especially if it is a one-off tax.[66]

A related argument is that windfall taxes distribute equitably the costs of government and assist materially to promote equality of opportunity amongst economic operators.[67]

On the other hand, it could be argued that notwithstanding the short-term economic benefit it brings, a windfall tax acts as a disincentive for companies from investing in high risk projects and therefore reduces the tax income of the governments in the long-term.

> [A]lthough windfall taxes do indeed bring short-term revenues; they do significant harm because they distort long-term incentives.…
> [T]he most pernicious effect of windfall taxes is to dampen future investment and thereby raise prices [of capital and products] in the long run. The oil business is cyclical. It also has long lead times, so that today's profits would not be possible without investments many years ago. A windfall tax would discourage capital investment in risky oil and gas fields.[68]

This is a widely shared view amongst investors in the energy and mining industries. For as David Porter, U.K. chief executive of the Association of Electricity Producers, warned against the imposition of windfall tax on the energy industry in 2008, 'a legalised raid on the company[ies'] bank accounts … would be very unhelpful because it would scare off investors and also could make the cost of investment much higher and, in the end, that would end up on the customers' bills'.[69]

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companies in the U.S. and Britain so as to help low-income families cope with their energy bills. See, 'Windfall Taxes: An Oily Slope', *The Economist* (5 November, 2005) 14.

[66] Kades, supra (n. 29) 1494-95; Chennells, ibid at 287-88; Plehn, supra (n. 34) 283-84.

[67] L Brown, 'China: Windfall Tax on the Petroleum Industry Introduced' (2006) 17 *Int'l. Tax Rev*. 97 (noting 'revenues from the special profits tax can be used as a subsidy to farmers, fishermen, taxi drivers and other public utilities, which have been adversely affected by rising oil product prices.'); Adams, supra (n. 30) 367-69.

[68] 'Windfall Taxes: An Oily Slope', The Economist, 5 November 2005, p. 14. When commenting on the U.K. windfall tax on utilities in1997, the Economist observed that: 'If people come to believe that when they make money the state may arbitrarily snatch a large part of it, they will not work hard, their country will be worse off, and over all tax revenues will be lower than if tax collection had been less capricious.' See 'Chasing Windfalls', *The Economist* (14 June 1997) 29; Chennells, supra (n. 65) 288-289; Kades, supra (n. 29) 1551-1552; Plehn, supra (n. 34) 296-297; Adams , supra (n. 30)392; Nakhle, supra (n. 2) 114-115.

[69] See 'Ministers back away from Windfall Tax on Energy Companies as pressure grows to help poor families', *The Guardian* (27 August, 2008).

There is ample evidence in the oil and gas and mining industries that support this assertion. For example, following the adoption of a windfall profits tax law on gold mining by the Mongolian government in 2006, it was reported that some 93 gold mining companies (about 50% in the industry) in the country discontinued their operations.[70] Similarly, as a result of the hike in taxes and tightening of other operational conditions in Venezuelan between 2005 and 2008, some major foreign oil companies have since exited the country, with adverse consequences on the country's oil output.[71]

Furthermore, windfall taxes might also lead to wasteful spending ('gold-plating') by companies with a view to reducing their profit margins subject to the tax.[72]

To sum up, although windfall taxes might seem very attractive to politicians (in political and economic terms) nevertheless they risk undermining a country's attractiveness to foreign and local investors.

V. Conclusion

In this contribution is that profits or returns together with the reasonable legitimate expectations of earning and enjoying same by the foreign investor should be considered as a separately protected investment under modern investment treaties' expropriation discipline as suggested by the dissenting opinion in the *EnCana* case and the jurisprudence of the ECtHR. This is consistent with the aims and objectives of such treaties, which include the protection of foreign investment whilst respecting host states' regulatory autonomy. Arguably, to provide too wide a margin of appreciation to governments over tax matters would risk undermining the main purpose of such treaties, ie constraining government actions by aligning them to be in conformity with the government's international obligations. As such, a heightened international judicial scrutiny of the so-called windfall tax measures adopted by host states may be justified on legal and policy grounds.

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[70] *Sergei v Mongolia*, supra, paras. 57 & 58.

[71] See 'Venezuela's Oil Revolution is Stalling', Petroleum Economist, March 2009. In 2008, three U.K. blue-chip companies decided to move their headquarters overseas due to concerns over uncertainty with regard to the U.K. tax regime. See, 'Windfall tax and blue-chip exodus spell double trouble for Darling', *Financial Times* (31 August, 2008).

[72] Kades, supra (n. 29) 1543 (noting in the context of war time excess profits taxes, '[w]hen the government took [eighty-six percent] of an excess profit … the tendency was to buy any article selling for £100 which had a value to the taxpayer of £14 or more … [T]he high tax rates can lead to such severe avoidance that a shrinking tax base more than offsets the higher rate and leads to reduced government receipts' (footnotes omitted); Haig, supra (n.34); Johnson (2003), supra (n. 7)141.

Professor Thomas Wälde: in memoriam of the Friend

Andrey Konoplyanik*

On October 11th 2008 a tragic accident occurred at the summer residence of Professor Thomas Wälde in the South of France that resulted in his untimely death. Professor (and the former Executive Director) of the Center of Energy, Petroleum and Mineral Law and Policy (CEPMLP), University of Dundee, passed away at the age of 59.

There is no need to introduce Prof Thomas Wälde to a professional audience, since in the world of energy and natural resources he was already the leading figure. Prof Wälde was arguably the top practitioner in the field of international energy and mineral law particularly in the area of establishing effective mutual relations between the host (usually a developing) state and a (usually foreign) investor – the oil and gas company involved in the exploration and production of energy resources. Unlike many other lawyers, he also considered the questions of legal practice in the field of subsoil use within their economic and political context and also in relation to their evolutionary development. He analyzed, proposed draft solutions and participated himself in the practical settlement of the problems related to legal assurance of subsoil-use projects. For Thomas 'effective legal assurance' means to reflect, firstly, a balance of interests between the owner of the natural resources (usually the state) and those of the investor (the company developing these natural resources), and, secondly, with the changing conditions and realities of the contemporary world.

Thomas understood that the interests of the state – the owner of the resources in place, on the one hand, and the private foreign investor, on the other hand, do not coincide 'by definition'. The task of the state is – to maximize in the long-term its economic (resource) rent (which means the sum total of both Ricardian rent and Hotelling rent). Within this approach, and especially for developing countries, it was equally important to provide quick budget revenues from development of its subsoil. The problem is that, until recently, the majority of host states among the developing countries lacked historically proven capacities/

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possibilities for independent exploration and exploitation of their mineral resources. In turn, the international companies working in the extractive industries, which had the technologies and, management, potential required to raise first-class loans, obviously needed to obtain guarantees that their, usually large multi-billion, investments would not only be paid-back, but would also bring a reasonable rate of return independently of all ambiguities related to the majority of the E & P projects.

International companies can, and are ready to undertake complicated technological and commercial risks, related to natural resources development, but they, nevertheless, endeavour to share these risks with the host state. But the companies usually aspire to receive an incremental premium for accompanying political risks – such as a change of government or their decisions within the project life-time (one needs to remember that the project's life-time can extend to several decades, while the electoral cycle is usually measured in terms of only a few years). Thomas understood that legal preparation of agreements accomplished between the state and the investor on specific conditions of natural resources development within a particular project, which are needed to minimize the risks of both parties, should reflect a dynamic balance of long-term interests of these parties to stabilize, and prove mutually beneficial within, the overall term of the field's development and exploitation.

Thomas Wälde's achievements in the field of formatting model (framework) contract relations between the states who own the resources in place, especially oil and gas resources, and transnational corporations which explore, develop and produce these resources, were well known and recognized.

Professor Wälde worked with very different states, such as Burkina-Faso and Mozambique in Africa, Thailand and Uzbekistan in Asia, Colombia and Venezuela in South America, and Estonia and Serbia in Europe. His activities were connected with such different countries as Saudi Arabia, Iran, India, China, Russia, Brazil, USA and many others.

Many of the model agreements which Thomas developed (or participated in developing) created the basis of petroleum and mineral legislation of many developing countries. But Thomas understood that life forges ahead, so even the well drafted legislation (although prepared with his participation), no matter how well it reflected the current balance of interests of the state and an investor previously, would require adaptation and further development in the meantime to match a new situation. This is why many students and post-graduates

from developing countries, who were studying in the CEPMLP, for their diplomas and dissertations focused on the issues and took account of the changing energy environment. They proposed draft solutions for further improvement of petroleum legislation, including that of their own countries, which was de facto formatted by Thomas (or with his active participation) years earlier. So it's nothing strange for me in the fact, that after Thomas passed away, this sad event triggered a deluge of responses that literally swamped the Internet immediately after October 11th through the portals that Thomas created (such as ENATRES and OGELFORUM) and that the oncoming mail was dominated by his numerous students and colleagues from dozens of developing countries which in practice have benefitted from legislation developed by Thomas (or which was developed with his participation).

Our face-to-face acquaintance with Thomas took place in the early 1990-ies, when he invited me to speak in his Center in Dundee University when I was still working at that time as Deputy Minister for Fuel and Energy of Russia with responsibility for external economic relations and direct foreign investments. At this time I was already acquainted with him in absentia – at sometime since the mid-1980-ies, and in particular with his work in the field of contractual relations between developing countries – host-states which own resources-in-place, on the one hand, and transnational oil and gas corporations aiming to develop these resources, on the other hand. Since that time our interests repeatedly reechoed or coincided. But there were three major topics on which, during sixteen years of our face-to-face acquaintance, our interests have always coincided (but, more importantly, it was our views that have coincided on a lot of issues within these three topics). We communicated a lot and interacted on these topics with Thomas which are:

(i) different forms of arrangements between the host state and an investor (including foreign investor) in the oil and gas sphere; this was the topic from which my acquaintance with Thomas in absentia began in the mid 1980's;
(ii) production-sharing agreements (PSA) which are the most effective form of arrangement – in our joint view – for the economies in transition, to stipulate the inflow of direct investments, at least in the initial stages of their transition when these countries are badly in need of investments, modern management skills and technologies, and when they are still lacking well-developed legislation, including for investment protection, and;
(iii) the Energy Charter Treaty as the only multilateral instrument of international law aimed at minimization of investment and trade risks in energy.

I think that such strategic coincidence of our interests reflects mostly the fact that both for Thomas and I, the main professional task has been the establishment of an effective relationship between the state and an investor in the energy sphere. This is the standpoint where our interests originate from to a variety of forms and mechanisms of such relations, to most effective contractual forms of such relations (PSA), and to international legal instruments aimed at minimization of the risks related to such relations (ECT). My interest was more oriented to the economic and financial side of such relations. Thomas was looking mostly at the legal side of the above-mentioned issues. And here his knowledge was deep and multifaceted.

In the sphere of his professional interests he was for the international community, from my viewpoint, an indisputable authority, which persuaded his interlocutors not by the weight of his reputation, but with the strength of his arguments. According to Professor Wälde himself, his objective in life was 'to see how the emperor looks beneath his clothes' and 'to find out how things really are' and, 'to detect and enlighten the real essence of occurrences' even if it turns out as hard-hitting and unwillingness for somebody's part. With all energy and optimism Thomas has been always determined to reveal constructive grounds in any discussion and to search for a mutually acceptable compromise in dispute settlement. This helped opponents to come to common decisions, independent of their mutually exclusive stance, as it might have seemed at the first glance, initially.

What has always linked/bonded Thomas and I/me, among other things, was the understanding that if it should be possible to select in each discussion or dispute the objective, based on well-founded economic interests of the antagonistic parties, then it should be practically always possible to develop and to propose to these parties a mutually acceptable compromise which will to a maximum extent consider their sound interests and herewith (which is very important) to allow the parties 'to save face'. But Thomas scarcely paid adequate attention to political modesty (etiquette in regard to political authorities) and he did not hesitate to voice unpleasant facts about partiality, empty rhetoric, dubious transactions and corruption in the extractive industries, which prevented and still prevents the parties to investment projects from gaining maximum effectiveness and mutually-beneficial legally-formulated parameters for their long-term cooperation. At the same time, Thomas staunchly supported transparent and honest agreements between the contractual parties and helped those who wanted to obtain a deeper understanding of these complicated disciplines.

Professor Wälde was an adviser to Governments and individual companies, he acted as mediator and arbiter in legal disputes, he published academic research papers on the topical issues of international law, he was a professor in and also headed the CEPMLP. This broad spectrum of activities allowed him to broaden and deepen his understanding of legal and contractual relations in the area of energy and mineral resources and to work constantly on its improvement.

Thomas spoke and wrote freely in English, German, French and Spanish. He had a working knowledge of Italian, Russian and Arabic. The broad sphere of his professional interests and practical activities covered the issues of investment protection and ecologic (environmental) legislation, international energy organizations and taxation, privatization of state companies and a non-discriminating attitude towards international expansion of such companies of developing countries and economies in transition. His attentive and thoughtful approach towards economic and political realities and their influence on legal decisions taken was extraordinary (and sometimes alien) to the lawyers of his circle. This made his views and recommendations especially valuable.

In 1980 he started working in the UN and later on he became an Interregional Adviser on Petroleum, Mineral and International Investment Law. It was from this period of Thomas's professional life, that some of his studies of the early 1980-ies summarizing international experiences in petroleum arrangements for a long time became my universal reference books on contractual relations between the host states and transnational oil companies. He acted as an adviser to more than 60 states on the issues of implementing domestic legal reforms and/or within negotiations on the particular subsoil project agreements.

In 1991 Thomas took the position of the Executive Director of the Center for Energy, Petroleum, and Mineral Law and Policy and later on he received from the European Commission the Jean Monnet Chair on European economic and energy law. Through all this time Thomas continued to pay special attention to the PSAs and singled them out as a special discipline in the law course in his Center. Potential attractiveness of PSAs as an effective instrument for/of finding balanced solutions for the host state and international oil company has further moved closer our joint professional interests with Thomas, especially during my period of heading up the group of drafters on the Russian PSA legislation under the Russian State Duma in the middle of the 1990-ies. We frequently discussed with him different aspects of the correlation between the Russian model of the PSA that we have developed in our group and its international analogues. I have met with his support and understanding within a broad spectrum of issues related to PSA and

its development in Russia as a form of licensing regime (or: subsoil use management regime) equal and parallel to the tax and royalty scheme dominating at that time Russia's subsoil legal management.

Thomas's works, analyzing different international legal aspects of PSA implementation, are well known worldwide. Less than a week before his tragic death I attended an international conference in Kiev, Ukraine. As one of the conference topics, Ukrainian legal experts were discussing practical aspects of PSA implementation in Ukraine, and they were broadly citing Thomas's works as the well-founded basis for their presentations and have shown this evidence on the screen quoting extensive citations from his works.

From the very beginning of the 1990-'s Thomas has been actively involved in the Energy Charter process and has been one of the major proponents of this process. He considered the Energy Charter Treaty as a product of compromise, but the only available multilateral instrument of international law that protects energy investment and trade.

We communicated a lot with Thomas on the broad spectrum of the Energy Charter-related issues after I left the Ministry in 1993 and thus have left the position of the Head of the Russian delegation at the negotiations on the ECT. In the middle of 1990's he invited me to participate in the book that he was editing and asked me to write a chapter on the Russian position at the negotiations. In addition to the fact that he has factually shaped the book and its structure, he has written himself a big and fundamental chapter (as usual) on the investment provisions of the ECT. He invited a large group of internationally-recognized specialists to write individual chapters on the different facets of the Charter process and ECT aspects. The majority of the authors that he has managed to gather for writing for this book are well-known gurus in their respective areas. And this is also an inherent capacity of Thomas – he easily managed to unite around himself highly professional groups of authors. This book became – and still is, from my view, - a kind of encyclopedia on the ECT and its historic role in international law.

At the end of the past decade we decided with Thomas to prepare a Russian version of this book based on the assumption that it would be helpful for Russian legislators (on the eve of their then expected return to the issue of ECT ratification by Russia) to understand legal particularities of this Treaty. The Russian version of the ECT book was published in 2002 and major Russian energy companies (such as Gazprom, Transneft, Surgutneftegaz, etc.) have sponsored this publication as well as the Energy Charter Secretariat (ECS) and the ENIP&PF Foundation which I was heading at that time. I remember

how happy Thomas was when he first held in his hands the Russian version of this book. I brought this copy and handed it to him publicly in 2003 in Vienna at the OPEC headquarters in front of delegations of OPEC member-states and of other energy-exporting countries during the OPEC Seminar on the ECT, where both Thomas and I participated - in my case in a new capacity as the Deputy Secretary General (DSG) of the ECS. Thomas also presented the results of his study on ECT made for OPEC and we both tried to prove to the energy producers the initially balanced character of the Treaty in terms of providing equal investment protection and stimulation for investors and their investments from both exporting, importing and transit states.

During six years of my work as the DSG of ECS (March 2002 – April 2008), we actively interacted with Professor Wälde. He was, in fact, an informal consultant of the Secretariat and one of the most active supporters of the Treaty and of the practical ways for its further improvement and of expansion of the zones of its implementation. He participated in some of our important internal discussions as an expert. In 2004 he was formally involved as an independent expert in the first comprehensive – since it was the first one to be held after ECT entered into legal force in the 1998 - Energy Charter Policy Review based on Art.34(7) of the Treaty and held once in every five years. The Conclusions of this Review created the basis of the Secretariat's practical activities within the next 5-year period.

We frequently discussed with Thomas, and he usually supported my ideas on the further improvements of the Energy Charter process. When we in the Secretariat were preparing for the 2004 Policy Review, he participated in May 2004 in our key debate on my presentation 'The future of the Energy Charter Process: to find a competitive niche' (available at http://www.encharter.org/fileadmin/user_upload/DSG/Presentations/2004/11-E-Brussels-28.05..pdf and at http://www.konoplyanik.ru/speeches/11-E-Brussels-28.05.pdf). He actively supported the necessity to organize within the political dimension of the Energy Charter the permanent discussion of the member-states on the existing challenges and risks related to the new developments within the international energy markets. Also covered were the ways and means of achieving an advanced reaction of the member-states to such risks, firstly by the instruments of international law, within the available Energy Charter instruments and, if/when necessary, on improving the existing and on developing the new instruments. This philosophy was later incorporated into the draft Conclusions of the 2004 Energy Charter Policy Review and was finally supported by the member-states, in particular in regard to the necessity for regular adaptation of the Energy Charter process in its multi-facet dimensions, including its legal and

political instruments, to the new challenges and risks of the international energy markets developments (Conclusion N 3). This philosophy was not shared at that time by everyone, both within the Secretariat and among the member-states, however well-argued support by Thomas of my position was very helpful, so we managed to finally find a consensus on the wording of this Conclusion N 3 within the key member-states but only at the very last moment – in the course of the Annual Meeting of the Energy Charter Conference at end-2004 which has approved these Conclusions (available at http://www.encharter.org/fileadmin/user_upload/document/Final_Review_Conclusions.pdf).

Some of our common considerations with Thomas on the ECT and its role in international energy are presented in our one and only joint article, published in Journal of Energy and Mineral Resources Law in 2006 (available at http://www.konoplyanik.ru/ru/publications/articles/410-JENRL-11.2006.pdf). Thomas did not manage to see its Russian version which was published in the Russian magazine "Oil, Gas and Law" in 2008-2009 already after his death (available at http://www.konoplyanik.ru/ru/publications/articles/konoplyanik6-2008.pdf;…(1-2009).pdf; …2-2009.pdf; …3-2009.pdf) with my obituary for him (available at http://www.konoplyanik.ru/ru/publications/articles/walde6-2008.pdf).

When Thomas headed the CEPMLP, University of Dundee, this Center was one of the ordinary research and educational centers, and the PhD students were numbered only in single digits. Under Thomas Wälde's supervision this Center developed rapidly.

His own professional reputation has promoted the improvement of both the Center's and University's positions in the international sphere and interdisciplinary areas. This was a unique combination of academic excellence and applied professionalism. During the ten years that Thomas headed the Centre, it became one of the major institutions within its spheres of activities, and achieved world wide renown, the number of PhD students is now measured annually by the dozen. Many of the CEPMLP's graduates hold leading positions in their respective countries' Governments and in other key national and international institutions, they impact influentially on the selection of the political courses and legal practices at the higher levels within their states which are mostly developing countries and transitional economies. Since both groups of these states have been playing an increasingly greater role in the international energy and mining, this further increases the role of the Centre, associated strongly with Thomas's name, and of its graduates in the world of international energy and mining.

During his work in the University of Dundee, Thomas Wälde, who possessed a broad net of professional contacts, managed to create a pro-active virtual platform for communication of the leading practitioners and scientists throughout the world. Though his formal residence throughout the 15 last years of his life was a tiny, cluster of only a few houses, comprising the village of Dunino, not far from the small university town of St. Andrews, and the moderate sized university city of Dundee around half an hours drive from Dunino, the influence of Thomas in his professional sphere was really global. Consequently Dunino village step-by-step, thanks to Thomas and the Internet, became a well-known worldwide center of a few international specialized internet-forums, which Thomas created and which he led forward like the ingenious moderator independent of wherever he happened to be in the world at a particular moment. He moderated these forums (ENATRES, OGEMID, OGELFORUM) with the aim of inspiring and supporting professional, open and depoliticized discussions of the actual problems of the international energy world. Many of the participants of this virtual platform became an immanent part of the intellectual community of Dundee University, yet some of them never once managed to set foot on the shores of Scotland, nor even managed to meet Thomas in person.

For those, whom Professor Wälde knew in person, especially for his students and post-graduates, he was second to none as a committed stimulator and leader who always found time for pertinent advice and practical help for those who needed it at that moment. Thomas was literally overfilled with ideas, he just spouted them and it seemed to me that he has been generating them on a constant basis. I have regularly noticed this, for instance, when he was moderating my lectures which I usually presented in the CEPMLP once a year as a Honorary Fellow of the Center. In the course of each of my lecture (for which we have usually selected with him quite different topics from one lecture to another) he usually began his interactive discussions with the audience on this or that idea of the presentation that he liked more. Sometimes he was immediately proposing to this or that student/post-graduate how it might be most effectively used to bring together the student's topic with some ideas immediately generated by Thomas on the basis of something that he had condensed from my speech. So usually these lectures became a form of dialogue between the three parties. Frankly speaking, I just can't imagine how it can be done differently - without Thomas being an equally active participant of each event non-dependent whether it is he who is a speaker, or he who is a moderator, or he who is just a part of the audience. He was always in professional action.

When he left his position of Executive Director of CEPMLP in 2001, he continued to teach there while he has expanded the area of his

professional activities as the moderator and/or international arbiter in dispute settlements. This has further improved his already prominent reputation in the international legal sphere in energy. When Russia-Ukraine gas dispute happened in Winter 2005-2006 and we in the Secretariat at the end-December 2005 have been preparing for potential implementation of the conciliatory procedure for transit dispute settlement for the case if both parties would not be able to reach an amicable bilateral solution (I was at that particular very challenging time shortly – within a two-weeks period, in the "crew change" between two General Secretaries – serving as an acting Secretary General of the ECS), candidacy of Thomas was considered among very few challengers for the position of potential conciliator of this dispute. Fortunately, Russia and Ukraine had reached bilateral agreement that time so conciliatory procedure was not initiated then though we have agreed to it with both parties as a B-scenario.

Thomas was Chief Editor and/or the member of the Editorial Boards of a few authoritative magazines. A few years ago he created his own electronic magazine *Oil and Gas Energy Law* (OGEL), and very recently – *Journal of World Energy Law and Business*. He was Chief Editor of both of them and, as usual, in addition to his other obligations, he has been reading and reviewing all incoming materials. Furthermore, he has been travelling extensively throughout the world, speaking at a lot of conferences, etc. It never fails to amaze me how Thomas was so hard-working and effective. It seemed that his day was at least twice as long, if one considered how much Thomas has been doing and managed to fulfill throughout his professional life.

Two weeks before his untimely death, Thomas said to the interviewer: 'One of my objectives in life for myself is to find out how things really are. That means I am one of these people who… even as a child, wanted to see how the emperor looks beneath his clothes. And there is a lot of what I call "informal knowledge" in every profession, in every walk of life, which is not written about because in writing or in conferences people present themselves, they market themselves, they present what they think is a "marketable personality". And my intention has always been motivated simply by my personal curiosity. I wanted to find out how things are in reality. And that's what my mission has been in a way, namely what I've created and ultimately by encouraging people to talk about how things are – the things you don't read in guidebooks and in academic treatises." (http://www.transnational-dispute-management.com/tw_obit.htm).

It is the curious and active people that have been moving the world forward. Thomas was one of those. In his professional capacity he has

markedly moved the world forward. In it's ongoing momentum in the sphere of energy and mineral resources law, the world will long be beholden to the legacy resulting from the results of the studies and activities of Professor Thomas Wälde which will be developed yet further by his colleagues, friends, students and followers.

…On the wall in my home office, just behind my table, hangs the framed diploma proclaiming my Honorary Fellowship in his CEPMLP signed by Thomas, always visually reminding me about my friend.

P.S. Why I wrote on PSA in the Festschrift for Thomas Wälde

This happened sometime in late 1985 – early 1986. It was at this particular time that I first knew the name of Thomas Wälde. I was working in the Institute of World Economy and International Relations (IMEMO), USSR Academy of Sciences, and was dealing with the international energy issues. IMEMO was maybe the key one among very few official Soviet think-tanks at that time. One of the privileges of this Institute was to tell the truth about the Western world to the highest Soviet authorities – USSR Communist Party's Central Committee, Soviet Government and State Planning Committee (GOSPLAN). It was just the beginning of the "perestroika" period and we in the Institute have experienced its effects in our job as well. The country's leadership was thinking about opening up to the international world. The first Soviet Governmental Decree on Relations with Foreign Investors[1] was being prepared to mark the beginning of the third historical wave of foreign investments into Russian/Soviet economy.[2] It was clear that foreign investors would be first interested in Russia's subsoil, energy resources in particular – the major item of Soviet export. The Academy of Sciences was asked to provide its analysis and advice on international experience in petroleum arrangements between host states and international oil companies. Our Institute was approached both by the Academy and directly by the Council of Ministers to do this job. I was asked to prepare such a review.

I found two studies of the then UN Centre on Transnational Corporations[3] on different forms of petroleum arrangements worldwide[4] to be used as

[1] USSR Council of Ministers Ordinances N 48 and 49 dated 13 January 1987.

[2] The first wave was initiated by the then Tsarist Russia during first Russian industrial revolution of end-XIX-beginning of the XX century and ended by objective reasons with the beginning of the First World War, the second one shortly took place during New Economic Policy of Soviet Russia in the 1920-ies and was ended with the beginning of Stalin's industrialization and collectivization policies.

[3] Now: UNCTAD Division on International Investment.

[4] United Nations Centre on Transnational Corporations, Alternative Arrangements for Petroleum Development: A Guide for Government Policy-makers and Negotiators, ST/CTC/43 (New York), 1982; United Nations Centre on Transnational Corporations, Main Features and Trends in Petroleum and Mining Agreements: A Technical Paper, ST/CTC/29 (New York), 1983.

a basic source of summarized and condensed information on the issue for my paper. As I knew, one of their authors was Thomas Wälde, who, as I found out later, served occasionally in a specialized legal advisory role in the United Nations system and who was dealing in UN CTC with research, publication and participation in technical assistance in the field of international regulation of foreign investment. That is how I first came upon his name in relation to concessions and PSA'a as the dominant forms of petroleum arrangements worldwide.

After preparation of the series of papers on the international experience in this sphere for my bosses, I have published the article[5] – the first detailed one in the USSR on this topic, – where I tried to develop further comparative historical analyses presented in the above mentioned studies with Thomas Wälde's co-authorship. These studies were of course, mentioned in my article as one of the main sources of summarized information on the topic. Later on, still in the 1980's, I read the book on petroleum investment policies in developing countries where Thomas Wälde was a co-editor.[6] And again his name has come to light within the mainstream of one of my then key professional interests, which was different forms of petroleum arrangements between the host state and the international oil companies. This topic later brought me to GOSPLAN, then, after the collapse of the USSR, to the Russian Ministry for Fuel and Energy, where I then got acquainted with Thomas in person.

In my obituary for Thomas Wälde in Russia, a shortened English version of which is published above, I have marked a few areas of our joint interest and historical collaboration with Thomas. PSA is only one of those areas. But it was the first one where I became aware of his competence and authority. And I thought that it might be rather symbolic to present in a book devoted to Thomas's memory and his professional qualities, a paper concerning the issue of PSA – since it was this topic that has initiated my acquaintance with Thomas, - as a tribute to him reflecting a continuous 'circle of life' of human's knowledge driven by human curiosity and the intention to know 'how the emperor looks beneath his clothes', as Thomas mentioned in his last interview.

[5] Which was entitled 'Main types and conditions of the agreements between host states and trans-national companies in the petroleum industry of capitalist countries' (А.Конопляник. Основные виды и условия соглашений, действующих в нефтяной промышленности капиталистических государств между ТНК и принимающими странами. - *'Бюллетень иностранной коммерческой информации' (БИКИ)*, 1989, Приложение # 10, с. 3-23).

[6] N Beredjick and T Wälde (eds.), *Petroleum Investment Policies in Developing Countries* (Graham & Trotman, London, 1988)

Global Financial Crisis to Put the PSA Regime in Russia Back on the Agenda

Andrey Konoplyanik*

In the middle of February 2009, within the framework of the Sakhalin-2 project, the first LNG plant in Russia was commissioned. The opening ceremony was attended by Russian President Dmitry Medvedev, who praised the work done by the project's shareholders and expressed satisfaction with the fact that Russia had become a member of the LNG exporters club.

It is common knowledge that the Sakhalin-2 project was implemented under the terms of a production-sharing agreement (PSA). The parties to this PSA are the Russian Federation, as the owner of the energy resources in place, and 'Sakhalin Energy Investment Company' – a so-called 'special purpose company' (or project company) established initially by a consortium of foreign investors (Gazprom is now a controlling stakeholder), to develop the Piltun-Astohskoye and Lunskoye oil and gas fields located offshore of Russia's Sakhalin Island.

The project has already survived ups and downs in the economic environment, including the default of 1998 and low oil prices of that period, highly favourable market conditions in recent years, and, several changes in the shareholders structure, etc. In spite of this, the project never 'died', and it has already generated over $1 billion in the form of royalties and income tax for Russia's benefit. It has stimulated development of Sakhalin's economy (previously one of the most underdeveloped regions of Russia since it is so distant from the federal center), etc. In other words, the PSA regime has not only proven to be viable, but also highly stress-resistant, which is very important for subsoil users in a time of crisis, when oil prices have dropped to their previous levels of the recent past. Production costs are constantly increasing since the new fields being developed are in the more remote regions with more difficult geological and geographical conditions; and loans have become considerably more expensive and debt financing more limited.

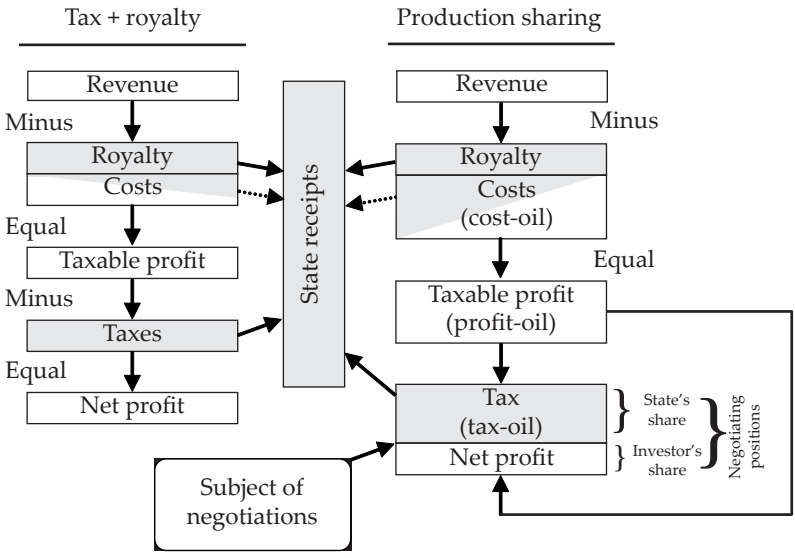
* Energy economist by background. Major professional areas – energy economics, energy & investment legislation, energy financing. PhD (1978) and Dr. of Science (1995) in international energy economics from Moscow-based State University of Management.

Thus again, as in the time of previous crises, the possibility of reviving PSA (or introducing different sorts of its surrogates) is currently being discussed at different levels, in particular at the ministerial level in Russia. Government officials believe that the current situation is favorable for returning to the PSA, in particular, offshore and in Eastern Siberia, because PSAs provide (investors with) legal grounds for project stability for quite a long period of time in a low oil price environment. Not all Russian Ministries are supportive of a PSA regime; key for subsoil use – the Ministry of Natural Resources and Ecology is strongly opposed to it. Although no specific decision has been made so far, some steps in this direction are being contemplated. The question is whether bringing back PSAs would be appropriate today in Russia.

As can be seen from Figure 1, the basic economic advantage of the PSA is that it provides an opportunity for the State and investor to find an equilibrium in the splitting of oil revenues that will be mutually favorable to both parties for the long term project life. This is true if the negotiated split results in a sliding scale dependent on the economic results of project's implementation. The key legal advantage of the PSA is that it provides an enclave of stability in the unstable legal environment of the host states.

It has been statistically evidenced, that the PSA is usually implemented in countries with a lower per capita income/GDP, compared to the countries with the tax and royalty schemes (see Figure 2 below). It is usually these types of countries that provide less legal stability for domestic and international investors, and it is in this regard that PSA is so welcome by energy investors in such countries.

Figure 1: Basic Difference Between Tax Plus Royalty and PSA Regime



Source: A Konoplianik, 'Complex approach for attracting foreign investments into Russian energy', Dissertation in form of scientific presentation for Doctor of Economics Degree. Moscow, State Academy of Management named after S. Ordjonikidze, 1995, p 81.

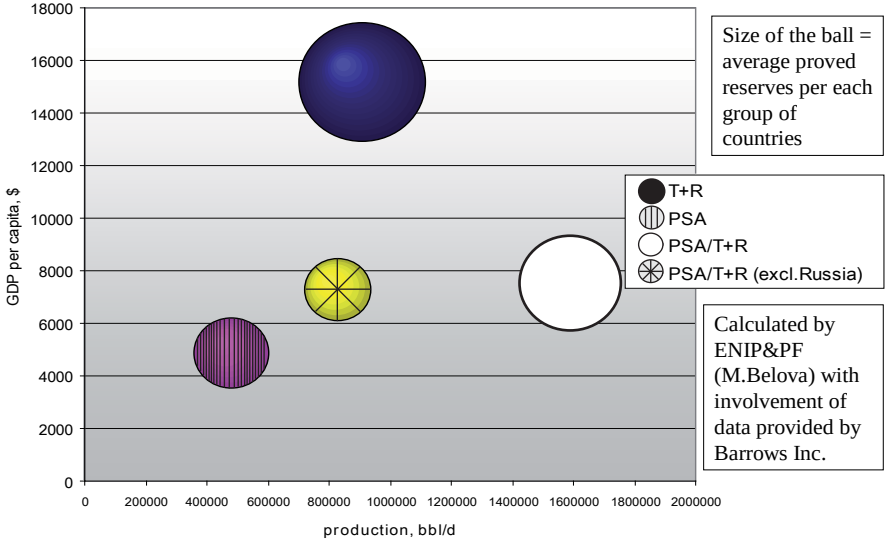
Crisis is not a reason but just an occasion

From the author's view, falling oil prices and financial and economic crisis, which, among other things, makes debt financing more difficult and costly, can arouse the lawmakers' interest in the PSA in Russia. Moreover, this demands the revival of the PSA in Russia as an investment regime for oil and gas field development equivalent to the existing subsoil use taxation regime based on MRPT[1], and not as a subsidiary or secondary one to MRPT regime. However, for me crisis is not a reason, but rather just another occasion to prove that a PSA regime, being of universal nature, works equally effectively, provided it is structured in the right way, to the benefit of the state (as subsoil owner) and investors under both low and high oil and gas prices. Through all my previous professional career (see selected bibliography at the end of the chapter), especially in mid-1990s, during the time when I have been heading the group of drafters of PSA legislation in Russia under the State Duma, I have been voting for the establishment of the subsoil

[1] MRPT = mineral resources production tax with currently flat rate since its establishment in Russia in 2002 (in Russian: NDPI = 'nalog na dobychu poleznykh iskopaemykh').

use system in my country with the two equivalent and equal investment and taxation regimes of the subsoil use: based on tax and royalty, on the one hand (now it's MRPT), and PSA, on the other hand (see Figure 3).

Figure 2: Oil Taxation Models vs. Average GDP per Capita, Oil Production and Reserves

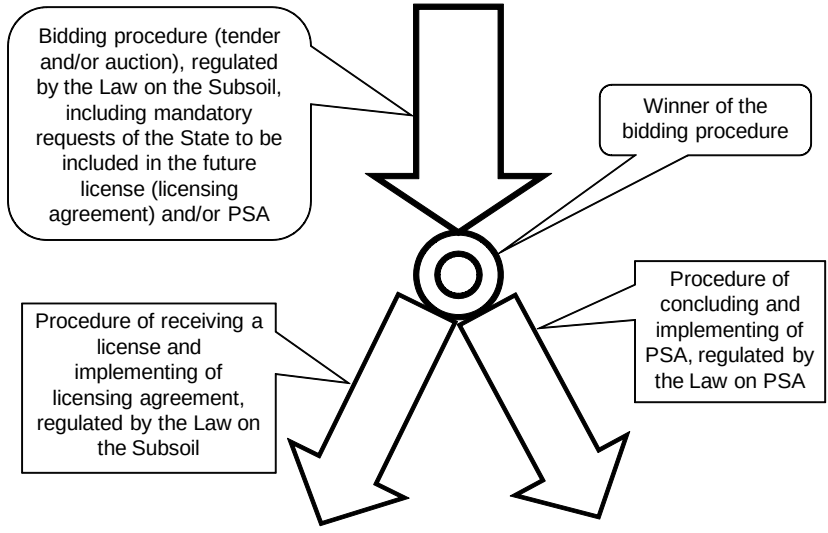


Source: A Konoplianik, 'Russian Oil Taxation System Development (a continuous debate between supporters of fiscal-oriented and investment -oriented approaches), 15th International Petroleum Tax Conference, 11-12 Dec. 2004, Oslo, Norway.

Unfortunately, our drafting group and supporters in the Government and State Duma did not manage to introduce this system in Russian legislation in full accordance with our intentions, plans and drafting proposals: the opponents to the PSA regime (whose numbers were and still are rather large in my country) managed first to diminish the role of the PSA regime to the subordinate and supplementary one to 'tax and royalty' subsoil use regime. Since the very beginning the PSA in Russia was considered as an exemption to the general subsoil use regime based on tax and royalty. Later on, the PSA opponents[2] have managed, through amendments to tax legislation, signed by the Russian President in 2003, to factually forbid implementation of the PSA regime in Russia[3]. So today PSA regime de jure is present in the Russian legislation, but it is squeezed by so many administrative barriers that currently it is

[2] Headed by Mr.Khodorkovsky, former President of the former YUKOS oil company.
[3] Motivation of the opponents to PSA is presented in the author's publications of early 2000's listed at the end of this chapter.

Figure 3: Two Equal Regimes (Author's Historical Proposal)



Source: А Аверкин, А Конопляник, М.Субботин. Инвестор свои деньги не отдаст. Пока не получит правового единообразия. – "Нефть и капитал", 1995, № 12, с. 10-12

totally impossible to introduce new projects on PSA grounds in Russia. To make the PSA regime workable these barriers need to be lifted.

In the existing environment, in the case of a flat MRPT rate, taxes are fixed and constant and not dependent of the natural and/or entrepreneurial efficiency of the project. This means that during an economic crisis (like the current one) the profit generated by producing companies starts to shrink sharply, which naturally holds back new projects from being developed. The government, due to its bureaucratic inflexibility, is not able to adjust a MRPT with a flat rate in line with oil price fluctuations or production cost changes. And even if a mechanism to make such adjustments is in place (as is in the case with oil export duties), the MRPT flat rate will remain uniform for all fields with different economic conditions. This means that the key disadvantage of the MRPT (from the point of view of potential investors in the Greenfields) – its universal nature and the same tax burden for fields with different production cost levels — will not be removed by the improvements of the MRPT system.

The times when we developed in Russia large fields located close to energy consumption centers are long past. This means that the costs – the so-called 'technical costs', i.e. of putting new fields on stream – are constantly increasing. Against the background of the financial crisis,

financial costs (the cost of raising external finance) are also increasing, which, among other things, is due to a lack of liquidity and more costly investment resources.

Most new fields are developed on the principles of project financing. This means that the project companies, which more often consist of consortiums of strategic investors, invest in their project's development borrowed funds (debt financing), and not their own funds (equity financing). This allows them to further mitigate risks by sharing the latter with the financial community. The source of debt repayment is the project's future profit. A package of legally binding project documents provides security for the funds raised for the development of this project. If these project documents do not show that sustained profit allowing pay-back of invested funds is to be generated during future long-term field development, no loan will be granted to the investors. Therefore, new fields will not be put on stream. Thus, high borrowing costs (costs of raising capital) appear to be one of the key disincentives for companies with respect to new field development, which consequently results in considerable delays in developing new regions.

Relatively low credit ratings of Russian vertically integrated oil companies (VIOC) also play a negative role. Today, Russia's long-term investment rating is within BB category and is one of the lowest investment ratings among the major producer countries. When Russian companies develop their projects in Russia they are bound by this rating as a ceiling. There is a general rule in project financing (and I know only one exception from this rule – and this is Qatargas LNG): the rating of the project can not be higher than the rating of the company(ies) that develop this project, which in turn, can not be higher than the rating of the country in which this project is being developed. At the same time the world's major VIOC have usually higher investment grades, including AA-AAA ratings for the super-majors. Under more or less standard conditions, low ratings mean higher borrowing costs for Russian companies, while during a crisis they just deprive them of the opportunity to borrow from Western banks and other international financial institutions. That is why for our companies, financial costs grow at priority rates. As a result, Russian companies, as majority stakeholders in new field development projects, cannot raise loans to develop the fields on favourable terms, on the one hand, and they are restricted in cooperating with foreign investors by new legislation, on the other hand. As a result new field development is suspended.

Two equal regimes

From my view, the PSA regime is to start functioning on a par with the existing tax system. I have always been opposed to a flat subsoil use tax rate, because, in my view, it is favorable only for those companies that develop the easiest fields. At the same time, complex fields, which companies would be willing to develop if the state offered a milder tax treatment, are not being put on stream (see Figure 4).

Figure 4: Comparison of Flat-Rate MRPT and PSA Systems

Figure 4.1: Flat-rate Tax System

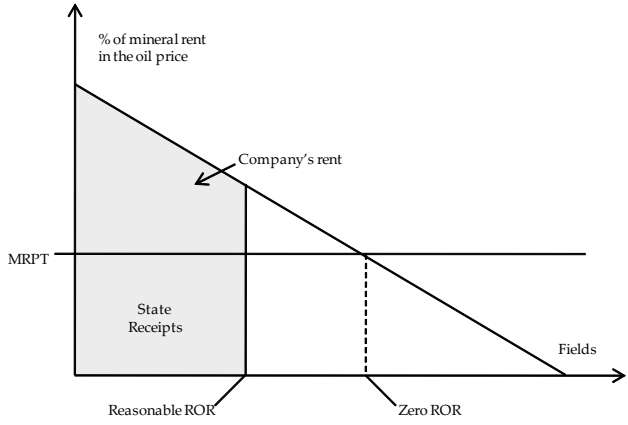


Figure 4.2: PSA

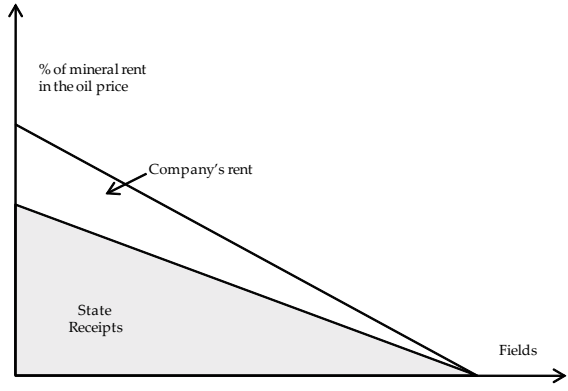
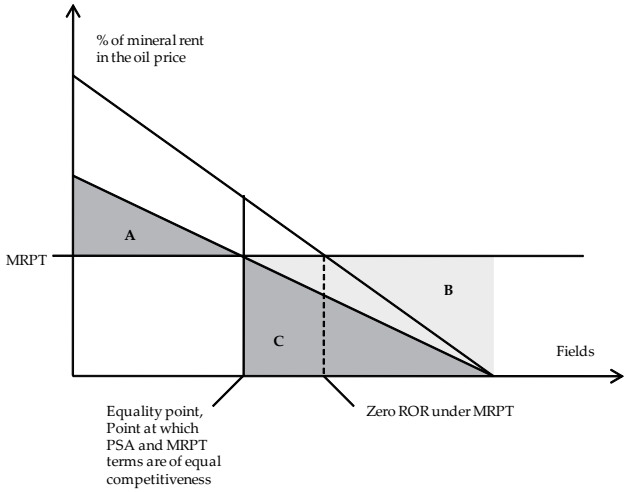


Figure 4.3: Transfer from MRPT to PSA



A: Companies' incremental rent-type earnings under MRPT, which transferred into state take under PSAs
B: Revenues that the opponents of PSAs wrongly claim are lost to the state under transition to PSAs
C: Incremental state earnings under PSAs through development of non-profitable fields under MRPT with flat rate

Source: A Konoplyanik, 'A struggle for mineral rent', *Petroleum Economist*, August 2003, p. 23–24; Андрей Конопляник: «Ухудшение экономических условий возвращает на повестку дня законодателей вопрос целесообразности реабилитации СРП». – «Нефть и капитал», 2009, № 3, с.18-23.

When oil prices have fallen from a maximum of almost $150/bbl (which did not reflect, from my view, the fundamentals of the oil market situation),[4] to below the level at which companies will be able to survive and start up new fields, very few tax regimes make it possible to work in such conditions. And the PSA regime is one of those few, because it ensures gross income distribution (taxes + net income) in a way that allows the state to receive maximum tax receipts, while leaving an acceptable profitability rate for the companies. This means that companies do not generate income based on the leftover principle, and the state does not collect maximum paper income, while actually benefiting from the fact that projects are operating (see Figure 1).

In my view, deterioration of the economic environment puts the issue of returning to PSAs on the lawmakers' agenda in order to remove the encumbrances of the tax treatment introduced in 2003-2004, which actually disabled it.

[4] The author has argued this thesis in a series of his articles, published recently in Russia and Ukraine: 'Кто определяет цену нефти? Ответ на этот вопрос позволяет прогнозировать будущее рынка «черного золота' *Нефть России*, 2009, № 3, с. 7-12; № 4, с. 7-11; 'О ценах на нефть и нефтяных деривативах', *Экономические стратегии*, 2009, № 2, с. 2-9; 'О причинах взлета и падения нефтяных цен', *Нефть и газ*, 2009, № 2, с. 2-4, 6-8, 10-11 *(Украина)*; 'Нефтяной рынок необходимо реформировать', *Время новостей*, 12 декабря 2008 г.

There is of course no guarantee that if PSAs are reintroduced investors will prefer to invest, rather than take a wait and see attitude in a crisis environment. But there is a system of economic incentives. It is quite evident that those investors aiming to maximize short-term financial effects and those regarding the oil business as just a part of a wider investment strategy will play a waiting game.

PSAs are designed for another category: investors who do not intend to leave the industry under any circumstances — here I mean VIOC in the first place — and are aiming at efficient recovery and replacement of reserves. They are aware of the fact that the infrastructure they set up must function at maximum efficiency. That is, they are interested in stable production volumes (at maximum efficient recovery rates) from existing fields and putting new fields on stream with a certain lag to ensure the process of expanded reproduction at minimum costs.

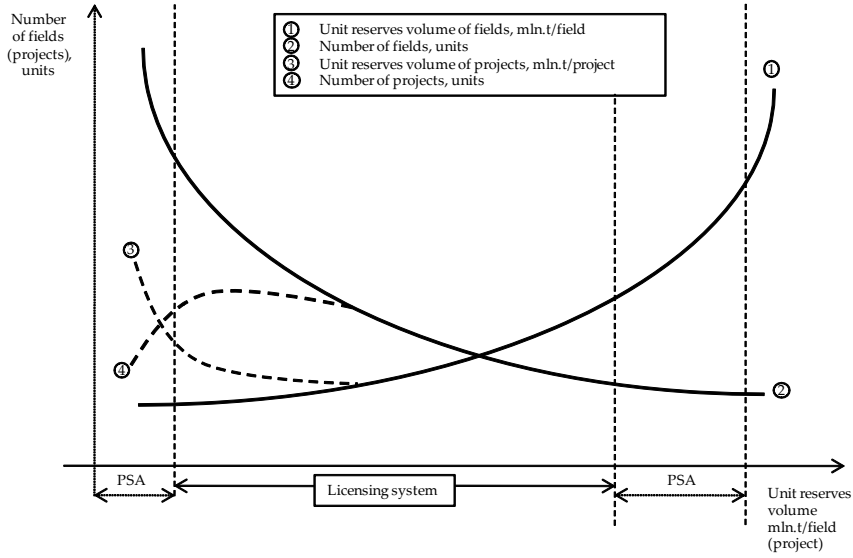
This is a key issue. I believe that the companies benefiting from waiting now will lose in the long-term outlook, because they won't be able to avoid the continuing decline in production at developed fields. And instead of gradual and relatively regular investment, they may face the need for increasingly expensive financing in the context of sharp fluctuations in demand for investment. Therefore, companies operating in the oil business rely on long-term mechanisms, not on immediate considerations. And a PSA allows them to predict developments and adapt to changing external conditions for implementation of their projects.

Who will benefit from the PSA?

The PSA regime is also interesting for developers of minor fields, who are cut-off from field development by the current MRPT regime (Figure 5). Providing a sliding scale of production-sharing, such treatment provides a means of developing such fields and thus expanding the resource base utilized by the state. Naturally, the income for the state from developing minor fields under a PSA will be less than the Ministry of Finance could calculate under a flat rate tax scheme (Figure 4). However, the income calculated, as if collected within MRPT regime with the flat rate, will only look good on paper, because if a company does not foresee an acceptable rate of return, it will choose not to implement the project. If minor fields are put on stream on PSA terms, the state will get the maximum resource rent it can realistically receive from them.

Who develops minor fields? Small and medium-sized companies. That is, by authorizing PSA for minor fields, we set up a base for the development of such companies. In most cases, these are regional structures, which can expand resource flows to the domestic, not foreign

Figure 5: PSA Preferential Application Zones



Source: A Konoplyanik, 'The Fight Against PSAs In Russia: Who is to Benefit and Why Not the State?' (October 2003) 10 *International Energy Law & Taxation Review* 277-286.

markets, filling in the niches in which VIOC are not interested. By the way, this is a way to promote demonopolization of the Russian oil and gas industry.

As for the MRPT treatment, it may appear to be preferable for fields located in developed regions with well-developed infrastructure. In this case, the lower efficiency of the MRPT compared to PSA may nevertheless be compensated by the lower costs of introducing MRPT, because it will allow a project to be launched within a shorter period of time than in case of a PSA. And the smaller the project, the greater the weight for calculating discounted cash flow the time factor has.

In my view, all projects not easily accessible deserve a PSA: offshore, Arctic offshore in the first place, Eastern Siberia and other remote regions. Any place where each project not only implies field development, but also requires setting up macroeconomic infrastructure and thus acting as regional development instrument through its multiplier effects, deserves a PSA.

Another category includes groups of minor fields that are currently not being developed. An example is the Udmurt project in the center of Russia, which I was once involved with: 10-15 minor fields are located

within the area with already existing infrastructure in the center of a developed region; however, their individual development is capital intensive (in terms of unit costs per field due to small size of each field). However, in order to launch such projects under PSA terms, one should redistribute authority, because it is quite difficult to initiate, control and regulate projects from Moscow. Initiatives must be redistributed: megaprojects should be initiated and regulated by the center; and minor projects, at the regional level. Further adaptation of the 'one key' principle might be required: its distribution between federal and regional authorities depending on the class of assets (e.g., volume of reserves). And, in my view, it should be legally possible to unite several minor fields within the framework of one project in order to reduce the profitability threshold of developing them (by implementing an 'economy of scale' approach).

The state will benefit from this solution, first of all, through resource base expansion. Furthermore, PSAs allow the state to cut excess resource rent (windfall profits) from those companies that generate higher profitability under a flat MRPT rate than the level of profitability in the industry on average (Figure 4). These highly profitable companies might be in the privileged position due to the fact that they, for instance, have received in the course of privatization in the 1990s (especially in the course of 'loans for shares' deals) already pre-developed or already developed fields for free (or almost for free) from the state. In the first place, these include companies operating simple fields and placing their products on the export market. Under the PSA, such windfall profits (i.e. generated from field development that is not justified by business activities) can be withdrawn, in part or in full.

What changes are needed?

It is clear that the reintroduction of the PSA will require tangible changes in the laws. I am convinced that we need to set up a licensing system that will allow companies to choose between the existing regime of subsoil use (tax and royalty, means MRPT) and the PSA. Naturally, the state will have to evaluate (pre-calculate) the relevant terms and conditions for each project to be licensed beforehand and offer the companies a licensing regime that meets their mutual interests (the host state and investor) as far as possible. The state will have to establish key (threshold) parameters for developing specific fields based on their most efficient recovery rates, below which companies may not go when submitting their bids, nor when the winner will implement this project (Figure 3).

At the same time, the PSA should not be a mechanism of 'exemption from acting legislation', as PSA opponents have always tried to present it and as, regrettably, it is arranged and functioning today. An exemption regime, especially when it is fixed as a resource quota (say, no more than 30% of the country's proven reserves, as was the case in the 1990s in regard to the PSA), on the one hand, promotes speculative demand, which is not economically justified, and, on the other hand, expands the grounds for potential abuses on the part of decision-makers with respect to including projects in this quota.

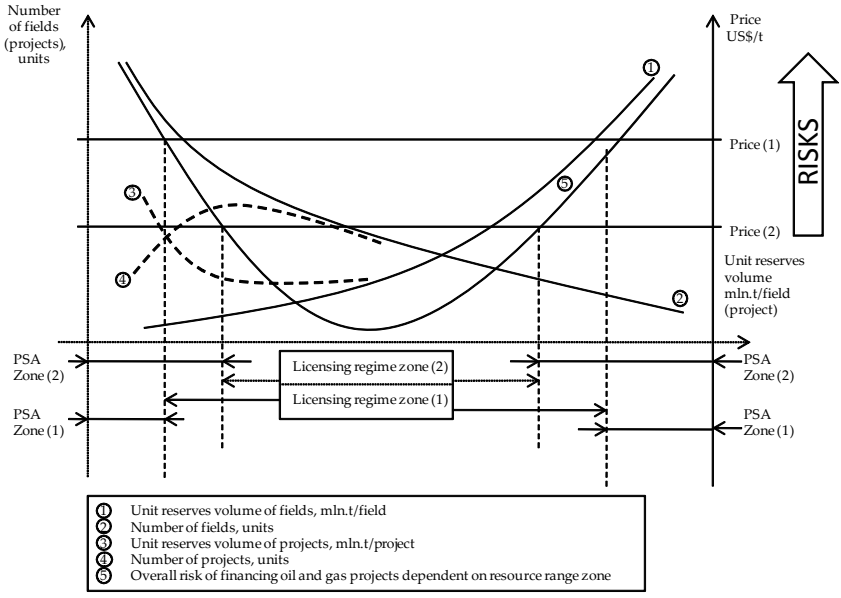
When we are speaking about simple fields, an auction system is justified. It assumes payment of a one-off bonus — which represents a kind of expensive entrance ticket and a further operation under the universal rules of the existing tax system. This is quite natural in places where the geological structure is not complicated and where there is no need to build macroeconomic infrastructure. In the case of difficult and large fields, where discounted cash flow is to be calculated for the long-term outlook, a tender system should be in place in my view. And in this case, a high 'entrance ticket' price (direct upfront cash payment to the state) is often not enough to ensure maximum discounted cash flow for the state through the entire period of field development.

The question here is what is more important for the state: to get a maximum one-off payment and many times less during the entire period of field development, than possible, or vice versa? The first option can also be justified, when, let's say, people have nothing to eat and one has to feed them today at any cost. Today we are not in a situation like this, which is why long-term income for the state is more important, despite the fact that we are facing a global financial crisis.

I think that for minor regional fields, an option including the PSA and an auction system of acquiring subsoil use right may be suitable. A license agreement correctly drawn up by government authorities requiring early field development should be a guarantee that a major VIOC will not buy these projects for future use (and now will put them on hold) or financial structures will not buy them for resale. When choosing the subsoil use regime and acquiring a subsoil plot in accordance with these conditions, the company shall be obliged to follow it and there should be no possibility of transfer to another regime after it won the bid (Figure 3).

Furthermore, a mechanism should be set up to protect the parties' interests for any license regime. An appropriate example here may be the practice of long-term gas export contracts (LTGEC). They do not fix the price in the LTGEC, they provide a pricing formula and mechanisms

Figure 6: Evolution of PSA Zones with Oil Price Fluctuations



Source: A Konoplyanik, 'The Fight Against PSAs In Russia: Who is to Benefit and Why Not the State?' (October 2003) 10 *International Energy Law & Taxation Review* 277-286; Андрей Конопляник, 'Ухудшение экономических условий возвращает на повестку дня законодателей вопрос целесообразности реабилитации СРП', *Нефть и капитал*, 2009, № 3, с.18-23.

for price review for the entire contract period (which should be at least as long as in case of field development). This mechanism works between many pairs of economic entities, so why shouldn't a similar adaptation mechanism work between the state and a subsoil user?

Speaking of the PSA, the contract must stipulate the terms and conditions under which the revenue distribution mechanism (production sharing) changes. A standard PSA and a standard license agreement subject to MRPT should be prepared in which all issues indicated above should be specified. These documents must be offered to potential subsoil users at the beginning of their participation in the bidding for subsoil use right. That is, I repeat, a licensing system providing for two equally valid investment regimes of subsoil use should be set up (Figure 3).

If the subsoil tax regime and PSA are applied on an equal basis, the boundaries between the areas of their preferred application will be flexible and may change depending on the pricing environment (see Figure 6). In case of high oil prices, companies will have more incentives

to apply the MRPT, since, all other things being equal, for 'average' fields (the median sector of the resource range) high prices will compensate for the relative inefficiency of the MRPT in resource rent distribution. And, conversely, in case of falling oil prices, the importance of optimal resource rent distribution for each specific project will increase; and, therefore, the importance of the PSA as an instrument for ensuring such distribution will also increase. Therefore, under these conditions the area of its application will logically expand. That was, by the way, proven by the historical changes in the level of support for PSAs in Russia: one of the highest it was in 1998, when the global oil market collapsed and prices fell below $10/bbl, and the PSA was frozen in 2003-2004 when the oil price rise started and it was expected that it would be a long-term upward oil price trend. Therefore, the areas of subsoil tax and PSA application will be able to (and will) change as a result of economic incentives having an effect on the companies, not as a result of administrative pressure.

The above-described scheme for improving the licensing system will create the conditions for competition between two investment regimes for the subsoil user, which will have a positive impact on the efficiency of the Russian subsoil use system as a whole.

It should be noted that the PSA will become an instrument for ensuring optimal distribution of resource rent within the framework of each project only if the relevant legally binding documents are correctly prepared by authorized government bodies and negotiations are competently conducted. In turn, this puts forward additional requirements for the level of professional training of the experts for governmental authorities (this may be one of the reasons why some government officials, especially from the key for the subsoil use Ministry of Natural Resources and Ecology, are opposed to the PSA).

Not to repeat mistakes

This is needed to avoid situations similar to the ones that have taken place, for example, with the Sakhalin-2 PSA. At that time, in 2003-2004, under conditions of rising oil prices, the absence of a 'cost stop' parameter in the agreement might not result in an increase of tax portion from the 'profit oil' for the benefit of the state (so-called 'tax oil' – Figure 1). This was, in my opinion, the actual economic reason for the subsequent requirement by the state to revise the terms and conditions of the agreement and to change the shareholder structure of Sakhalin Energy Investment Company.

In order to force foreign shareholders to revise the terms and conditions of the agreement, 'an ecological stick' was used in place of transparent and sound arguments related to material changes of the terms and conditions of the agreement (similar to the above-mentioned long-term gas export contracts), which were within the sphere of international law. Once again, instead of the 'force of argument', the 'argument of force' was used…

By the way, if Russia had chosen the first way of eliminating deficiencies in the agreement, it would not have had to face strong criticism of the methods used to resolve Moscow's valid concerns about the Sakhalin-2 project. Similar international criticism could have been avoided by Kazakhstan, which stepped on the same rake some time later with a PSA project on the Kashagan field — for choosing methods to protect the valid interests of a sovereign state as the owner of subsoil and non-renewable natural resources. But that's another story.

PSA opponents may object: why return to the PSA, if MRPT tax holidays have already been provided for offshore fields in Eastern Siberia, Yamal and northern regions of Timano-Pechora? And it is also expected that export duties for Eastern Siberia will be abolished. Will tax treatment be worse than PSA in this case? But from my view all these reasonable lightening of MRPT regime (like tax holidays) will not have such an overall effect as the introduction of the PSA. These slight improvements to the MRPT regime are a single incentive granted unilaterally for various fields of one and the same region.

It does not represent an agreement optimized with consideration of specific project features, which is reached as a result of negotiations between the parties (host state and investor) and provides for such a legally binding distribution of resource rent, where the state gets its maximum portion of the rent and the investor gets a rate of return acceptable to it.

Thus, the abolition of export duties may be of interest to the companies exporting a considerable share of extracted hydrocarbons, whereas this measure makes no difference to companies operating in the domestic market …

Furthermore, for me application of the PSA is not to be based on the geographical principle. It is not a question of setting up of centers of potentially favorable subsoil investment treatment ('potential' — because I don't know what we will have in the end) in specific regions. It is a question of applying the PSA across the entire country, on a competitive basis and on par with the MRPT tax treatment, in cases where it is justified from the economic point of view.

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All publications and presentations of Dr.A.Konoplyanik are available from www.konoplyanik.ru.

Interpretation in International Investment Arbitration – Through the Looking Glass

Ian A. Laird*

I. Introduction

> 'When I use a word', Humpty Dumpty said, in rather a scornful tone, 'it means just what I choose it to mean – neither more nor less'.
>
> 'The question is', said Alice, 'whether you can make words mean so many different things'.
>
> 'The question is', said Humpty Dumpty, 'which is to be master – that's all'.
>
> Lewis Carroll, *Through the Looking Glass*

In Lewis Carroll's book, *Through the Looking Glass*, the protagonist Alice enters into an alternate universe and meets the storybook character Humpty Dumpty who converses with Alice about the meaning of words.[1] The conversation suggests that sometimes it is necessary to ask the question as to why a particular word is being used and by whom. Words do have multiple meanings, as Alice observes, telling the reader that the more interactive application of the concepts of intent and context may play a strong role in their interpretation. In the world behind the looking glass, no less than the world of international investment arbitration, mastering the meaning of words is an active process between the writer, the reader and the words.

The late Professor Thomas Wälde noted in one of the last papers he drafted in the summer of 2008 that few authors have given formal attention to the subject of interpretation of investment treaties.[2] He mentioned in

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[1] Lewis Carroll, Through the Looking Glass (1872), at Chapter VI. An internet copy of the chapter is available at: http://www.literature.org/authors/carroll-lewis/through-the-looking-glass/chapter-06.html.

[2] T Wälde, 'Interpreting Investment Treaties: Considerations and Examples highlighting Confusion Arising and Clarity Desired', chapter in Binder et al. (eds), *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (Oxford 2009) ('Wälde').

particular Professor Christoph Schreuer as one of the few authors who have indeed made a life long scholarly interest in the interpretation of treaties.[3] Although the essay stated the fairly ambitious objective of addressing 'particular challenges of interpretation of investment treaties before international tribunals', Professor Wälde modestly stated it was not his intention to provide 'an exhaustive and comprehensive study (that challenge is still open) but rather a commentary on selected issues that have been noted recently and which have occurred in my practice.' However, as was usually the case when Professor Wälde turned his mind to a complex issue, this modest goal turned into a significant think piece on this most challenging of developing issues.

Professor Wälde provided himself with the challenge of seeking a deeper level of understanding when he concluded in the first part of his essay that 'confusion, rather than clarity, prevails in today's practice of investment arbitration, notwithstanding increasing references to the Vienna Rules.'[4] Understanding the meaning of words and phrases, of interpreting treaties and authoritative texts, is the everyday task of practitioners in the field of international investment law and arbitration, but it has not yet been the subject of great analysis and discussion.

The fact that the process of interpretation in investment arbitration has not been well analyzed can be attributed to a number of factors. The first factor is the relative newness of the field and the recent surge in interest and application by claimants as a genuine remedy for rights that largely lay dormant in an international system focused on the state-to-state relation and diplomatic protection of aliens. This steady growth in arbitral claims is frequently attributed to the equally increased acceptance of international investment agreements by states, and in particular the robust and liberal multilateral free trade agreements which include investor-state arbitration provisions, such as the North American Free Trade Agreement (NAFTA) and the Energy Charter Treaty (ECT). Professor Wälde was an expert commentator, counsel and arbitrator at the center of these developments and talked frequently about the influences and changes these new treaties had instigated in the world of international investment law.

A second factor is a sociological one and relates to the people that make up the international investment arbitration community. Professor Wälde's large range of interests of course included a firm focus on the personal, psychological and human level of investment arbitration. Such a robust and friendly character, with no hesitance of speaking truth

[3] Professor Wälde also indicated his high regard for the recent work on the Vienna Convention of the Law of Treaties by Richard Gardiner, *Treaty Interpretation* (OUP, 2008), and Sir Franklin Berman's views in his recent arbitral awards, amongst others.
[4] Wälde at 725.

to power, Professor Wälde understood that the personal backgrounds of practitioners and arbitrators play a major role in how these arbitral processes are conducted and how the law is interpreted and applied. As Professor Wälde recognized, there are two main groups in the investment arbitration community, and this particularly relates to the small arbitrator community. These two groups are the commercial arbitration practitioners, who are largely centered in Europe, drawing their strengths from those practicing under the rules of the ICC, the LCIA and similar commercial arbitration institutions, and the public international law scholars, who are found all over the world, but also with a heavy influence from Europe, mainly from the UK and the German speaking countries. The non-Europeans make a strong showing in both these ranks, in particular from the Western hemisphere and the Antipodes. As part of this dynamic is the tension between civilian and common legal traditions, which includes frequently divergent views on the conduct of dispute resolution proceedings and interpretation of law. As Professor Wälde noted, 'At present one might even talk of a "struggle" for the soul of investment arbitration between the international commercial arbitration and the (public) international law bars.'[5]

The third factor, and partly a result of the dynamic above, is that the commercial arbitration community has largely dominated the investment arbitration community over the past ten years (when the vast majority of these awards have been made). The commercial arbitration culture brings a strong focus on facts rather than the law, with the prime objective being an effective resolution of disputes. Accordingly, although the interpretation of treaty law plays an important role, it has not been developed fully. The public international law community, of which government negotiators and practitioners play a large part, have been much more interested in the application of law in an international legal system. Those arbitrators with a public international law background, particularly those with experiences in the International Court of Justice, are much more inclined to produce the thoroughly reasoned decisions we have seen increasingly over the past few years.

Although the role of arbitrators is critical, a further factor which Professor Wälde felt should not be underestimated is the role of counsel in influencing the interpretation of the law. However, using his own literary allusion, Professor Wälde noted that in reality the light of public attention is focused on the awards produced by tribunals rather than the submissions of counsel by quoting Bertold Brecht and Kurt Weill's *Beggar's Opera*:

[5] ibid.

There are some who are in darkness
And the others are in light
And you see the ones in brightness
Those in darkness drop from sight.[6]

A final factor relates to the coalescing of the customary international law related directly to the question of treaty interpretation through the vehicle of the *Vienna Convention on the Law of Treaties* ('VCLT' or 'Vienna Convention').[7] There is no doubt that in the investment arbitration awards of the past ten years, as Professor Wälde himself observed, the Vienna Convention has become the root source for the interpretation of international investment treaties. In particular, Vienna Convention Article 31 has become the starting point for the interpretation of most, if not all, recent tribunal decisions. Article 31 provides as follows:

Article 31 - General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

(b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

Moreover, the Vienna Convention is now universally acknowledged as being a statement of customary international law with respect to the interpretation of treaties.[8] However, it has not always been the case and many other principles and maxims of interpretation, frequently stated in a variety of Latinized terms, have dominated the international law world of treaty interpretation in the past. Also, as Professor Wälde and other commentators have recognized, although general homage is now paid to the Vienna Convention, interpretation is not always conducted

[6] ibid at 726. From the Ballad of Mack the Knife, which can be found at http://en.wikipedia.org/wiki/Mack_the_Knife. It is interesting to note that this final verse of the ballad, apparently not included in the original play, was added by Brecht for the 1930 movie to express the theme of the ballad's comparison of the glittering world of the rich and powerful with the dark world of the poor. The comparison by Wälde of legal counsel with the poor and murderous Mac the Knife is at the very least thought provoking.

[7] Vienna Convention on the Law of Treaties (VCLT, Vienna Convention 1969), 1155 UNTS 331; 8 ILM 679 (1969); 63 *AJIL 875* (1969), IC-MT 011 (1969).

[8] As noted by Gardiner at 16, 'That the [ICJ] Court views the Vienna rules as general, or customary international law, seems incontrovertible.'

in the exact manner as set out in the Convention. This inconsistency of application is the 'confusion' prevailing in today's practice of investment arbitration that Professor Wälde sought to clarify.

Professor Wälde well noted that this topic is one which deserves extensive treatment and analysis. However, there are a few starting points for this debate which can be addressed in this short offering. The most interesting place to start is the phrase repeatedly quoted from the Vienna Convention as the foundation for interpretation in Article 31(1):

> A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

Firstly, I will briefly address an important philosophical issue which is at the root of the interpretative exercise involving international investment agreements that concerns the application of the concept of 'good faith'. This issue raises the question of whether investment treaties should be interpreted for the benefit of states (as one may expect in a state centred system) or for the benefit of the subjects being protected under these treaties, the 'investors', or based on some form of balance between the two. This has resulted in the debate concerning whether investment treaties should be constructed 'strictly' or not.

And, secondly, the potentially difficult question arises in the application of the Vienna Convention Article 31 – what is the ordinary meaning of 'ordinary meaning'? The role of the ordinary meaning element in the context of a provision that also includes reference to context and purpose has been at the centre of much recent discussion in arbitral awards as to the scope and application of the Vienna Convention to international investment agreements. This is certainly a question that would be worthy of Humpty Dumpty.

II. Good Faith and the Strict/ Liberal Interpretation Debate

The concept of good faith is set out in the Vienna Convention in a number of places, firstly in the Preamble where it is noted that '… the principles of free consent and of good faith and the *pacta sunt servanda* rule are universally recognized' and, secondly, at Article 26 (titled 'Pacta sunt servanda') stating 'Every treaty in force is binding upon the parties to it and must be performed by them in good faith.' And of course, in Article 31, it states that '*A treaty shall be interpreted in good faith*'. There is evidence that 'good faith' was included in Article 31 because of the desire to respect the principle of effectiveness.[9] As noted

[9] Gardiner at 149 citing Waldcock, 'Third Report Report' [1964] *Yearbook of ILC*, vol II, p 7, draft article 55(1). The draft included elements of good faith, a paragraph which did *Cont.*

by Gardiner, 'The concept [of good faith] is also used in the Vienna rules as an umbrella for the specific principle that an interpretation of a term should be preferred which gives it some meaning and role rather than one which does not. In international practice this principle is often given its Latin form *ut res magis valeat quam pereat*.'

However, contrary to this direction of the Vienna Convention is the re-emergence through a small minority of arbitral awards and commentary of the argument that significant deference should be granted to the conduct of governments with respect to investments and that a 'restrictive' interpretation should be applied to investment treaties and the jurisdiction of arbitral tribunals. Frequently these 'strict' interpretations effectively render treaty provisions meaningless in the context of the treaty's usual objective to promote and protect investments. Professor Wälde referred to this as the 'sovereigntist' or 'reductionist' approach to interpretation in international investment law.[10] The most important classic interpretative maxim invoked as the basis for a restrictive interpretation is '*in dubio mitius*'. For example, the *SGS v Pakistan* tribunal applied the maxim stating,

> Art. XI would have to be considerably more specifically worded before it can reasonably be read in the extraordinarily expansive manner submitted by the Claimant…. the appropriate interpretive approach is the prudential one summed up in the literature as in *dubio pars mitior est sequenda*, or more tersely, *in dubio mitius*.[11]

As noted by Wälde, 'the reference to "good faith" in Art. 31(1) is contrary to the purpose of "restrictive interpretation" to minimise obligations by the "in doubt less" (*in dubio mitius*) concept'.[12] In one of the first NAFTA arbitrations, *Ethyl Corp v Canada,* the tribunal applied the applicable rules of international law to clarify the broad question of NAFTA interpretation in the context of a jurisdictional challenge by the respondent, while responding to Canada's argument that the terms of Chapter 11 should be construed 'strictly'. The Tribunal refused to accord a limiting interpretation of terms Canada sought to stand as conditions precedent to jurisdiction, preferring an interpretation consistent with Articles 31 and 32 of the Vienna Convention:

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not survive into the Vienna Convention: 'Good faith, *inter alia*, requires that a party to a treaty shall refrain from any acts calculated to prevent the due execution of the treaty or otherwise frustrate its objects.' And at Wälde at 738

[10] Wälde at 733 referring to Gus Van Harten, Investment Treaty Arbitration and Public Law (OUP 2007) at 132-135 with explicit support for this position in the awards of *SGS v Pakistan* and *Loewen v US*.

[11] *SGS Société Générale de Surveillance SA v Pakistan*, Decision on Objections to Jurisdiction, ICSID Case No ARB/01/13; IIC 223 (2003), signed 06 August 2003 at para 177.

> The Tribunal considers it appropriate first to dispense with any notion that Section B of Chapter 11 is to be construed 'strictly'. The erstwhile notion that 'in case of doubt a limitation of sovereignty must be construed restrictively' has long since been displaced by Articles 31 and 32 of the Vienna Convention. As was so aptly stated by the Tribunal in *Amco Asia Corporation v Indonesia (Jurisdiction)*, ICSID Case No. ARB/81/1 (Award of 25 Sept. 1983), *reprinted in* 23 I.L.M. 351, 359 (1983) and 1 ICSID Rep. 389 (1993).
>
> *[L]ike any other conventions, a convention to arbitrate is not to be construed* restrictively, *nor, as a matter of fact*, broadly *or* liberally. *It is to be construed in a way which leads to find out and to respect the common will of the parties; such a method of interpretation is but the application of the fundamental principle* pacta sunt servanda, *a principle common, indeed, to all systems of internal law and to international law*. (Emphasis in original.)[13]

Investor-state tribunals have achieved broad consensus in their rejection of a restrictive interpretation of treaty texts in favor of an approach that focuses on the specific language of the provision and on the context, while remaining cognizant of the 'object and purpose' of each treaty in question.[14]

What this reveals is the constant pressure that exists in investor-state arbitration between the fundamentally state-based system and the rights provided for individual investors under investments treaties. For Professor Wälde, the reasons for the rejection of a restrictive interpretation of investment treaties were obvious (and deserving of a longer quote):

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[12] Wälde at 748.

[13] *Ethyl Corporation v Canada*, Decision on jurisdiction, Ad hoc—UNCITRAL Arbitration Rules; IIC 95 (1998); 38 ILM 708, 24 June 1998 at para 55.

[14] For example, a number of tribunals have made similar comments concerning the role of the VCLT and that there is no principle of restrictive interpretation, for example: *Canadian Cattlemen for Fair Trade v United States*, Award on jurisdiction, Ad hoc—UNCITRAL Arbitration Rules, IIC 316 (2008), 28 January 2008 at para 116; *Mondev International Ltd v United States*, Award, ICSID Case No ARB(AF)/99/2; IIC 173 (2002), 11 October 2002 at para 43: 'In the Tribunal's view, there is no principle either of extensive or restrictive interpretation of jurisdictional provisions in treaties. In the end the question is what the relevant provisions mean, interpreted in accordance with the applicable rules of interpretation of treaties. These are set out in Articles 31–33 of the Vienna Convention on the Law of Treaties, which for this purpose can be taken to reflect the position under customary international law.' Also see: *Methanex Corporation v United States*, Partial award, Ad hoc—UNCITRAL Arbitration Rules; IIC 166 (2002) 7 August 2002 at para 105: 'We accept that the NAFTA Parties intended that the provisions of Chapter 11, particularly Article 1101(1) NAFTA, should be interpreted in good faith in accordance with their ordinary meaning (in accordance with Article 31(1) of the Vienna Convention), without any one-sided doctrinal advantage built in to their text to disadvantage procedurally an investor seeking arbitral relief.'

> Restriction on sovereignty may seem something to be worried about – but, essentially, any rule of international law, customary or treaty, inter-state or investor-state, is a restriction on sovereignty. It is in the very nature of law to restrict arbitrary behaviour. It would be difficult to find real obligations in international law, be it traditionally between states or in the contemporary international legal order between states and non-state actors – investors under investment treaties, individuals under human right treaties – if one would require absolute and specific clarity devoid of any ambiguity before accepting that treaty language creates obligations. Treaties, as all negotiated legal instruments, abound with ambiguities; ambiguity is necessary to find a ground for consensus.[15]

The task of addressing ambiguity and multiple meanings is at the heart of the interpretative exercise when an arbitrator seeks to divine the meaning of international investment agreements. Underlying this debate are some very fundamental issues as to how investor-state tribunals will interpret these ambiguities. The application of Article 31 and what 'ordinary meaning' means provides further evidence of the tension between the inherently state-centred nature of treaties and the protection of investors under those same treaties.

III. What is the Ordinary Meaning of 'Ordinary Meaning'?

In the ICSID *ad hoc* Annulment Committee's award in *Indústria Nacional de Alimentos SA and Indalsa Perú v Peru*,[16] Sir Franklin Berman took particular pains in his dissent to address his view of the proper process for the interpretation of treaty provisions under the Vienna Convention, as follows:

> The Vienna Convention tells us that the essence of treaty interpretation lies in extracting the ordinary meaning of the terms used, in their context, and in the light of the object and purpose of the treaty as a whole. It goes on to add that other indicators of the intention of the Treaty Parties may be admissible in defined circumstances for defined purposes. So when the issue was, as here, how the term 'dispute' was to be understood for the purposes of Article 2 of the BIT, one would have expected a number of straightforward enquiries to have been undertaken, including: a textual analysis of the provision in question and its purpose; an analysis of other connected provisions of the treaty; an examination of other places in the treaty where the same terms had been used, to see what light that might throw on the intentions behind Article 2; a discussion of the object and purpose of the treaty as a whole as a guide to the interpretation of Article 2; a search for whatever other material might be available to illuminate

[15] Wälde at 735.

[16] *Industria Nacional de Alimentos SA and Indalsa Perú v Peru*, Decision on Annulment, ICSID Case No ARB/03/4; IIC 300 (2007), 13 August 2007 ('Lucchetti Annulment') reviewing *Empresas Lucchetti SA and Lucchetti Peru SA v Peru*, Jurisdiction award, ICSID Case No ARB/03/4; IIC 88 (2005),7 February 2005 ('Lucchetti').

> the precise intentions of the Treaty Parties in agreeing to Article 2; and so on and so forth. There is nothing special about this list; the items in it are simply the normal tools of treaty interpretation.[17]

This describes in short order the workman-like process that arbitrator or counsel should undertake in peeling back the meaning of a specific treaty provision applying the Vienna Convention. What this suggests is that, although the ordinary meaning may be a starting point, the context of a term or clause in the treaty and evidence of object and purpose must also be taken into account in the interpretive exercise. As a starting point it is always much easier to read the text and begin in a rather literalist manner. Some tribunals look to dictionary definitions or merely make a statement as to what the obvious meaning appears to be. Looking to the literal meaning arguably provides some comfort to the interpreter because it appears to be the most objective, while addressing object and purpose, as Professor Wälde suggested, is potentially 'much more open to the subjective views of the interpreter'[18]

However, even a dictionary approach is fraught with difficulties and will result in multiple meanings being placed in contention. For example, the Oxford English Dictionary provides multiple definitions of 'ordinary', including as follows:

> d. Of language, usage, discourse, etc.: that most commonly found or attested; everyday, non-technical, spec. as contrasted with specialized terminology or (Philos.) logical symbolism.

Such a definition provides no comfort because it throws the question solidly back to the reader to determine what is an 'everyday' usage, or what is 'common'. The seeming objective appeal of the 'ordinary meaning' of 'ordinary' falls by the wayside. As noted by Gardiner, 'the word "given" in the phrase "to be given" [in Article 31(1)][19] is apt to emphasize that the meaning is not inherent in the text but something to be attributed to the interpreter, albeit using the text in the manner required by the rules'.[20]

The issue would seem to become less fuzzy when the meaning of a single term is well known and generally accepted. But does this mean that such a term is not open to further interpretation and the process is complete? Gardiner suggests it is still necessary to look to the context

[17] Lucchetti Annulment, Dissenting Opinion of Sir Franklin Berman at para 8.
[18] Wälde at 752.
[19] Recall Vienna Convention Article 31(1): 'A treaty shall be interpreted in good faith in accordance with the *ordinary meaning to be given to the terms* of the treaty in their context and in the light of its object and purpose.'
[20] Gardiner at 164.

to see if the result could be different from what the ordinary meaning produces.[21]

This raises an interesting conundrum with respect to the provisions inserted in many international investment agreements, such as the NAFTA, that allow the treaty Parties to agree on a binding 'interpretation' of a particular provision of the treaty.[22] Such an 'interpretation' was released by the NAFTA Free Trade Commission ('FTC') on July 31, 2001 to address the meaning of NAFTA Article 1105, which includes the substantive obligations of fair and equitable treatment (or 'FET') and full protection and security.[23] In particular, the FTC addressed the scope of NAFTA Article 1105, which provides that: 'Each Party shall accord to investments of investors of another Party treatment *in accordance with international law*, including fair and equitable treatment and full protection and security' (emphasis added). The relevant part of the FTC Note of Interpretation stated:

> Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.

In essence, with no supporting analysis, and certainly not an application of Vienna Convention Article 31, the NAFTA Parties took a single term, 'international law' and devolved it into its more limited sub-concept of customary international law. Certainly, this could not be considered to be an 'ordinary' meaning. It would seem to be subject to little debate that 'international law' is a term of art and is distinct from 'customary international law'.[24] For a term to be 'in accordance with international

[21] ibid at 169.

[22] For example, NAFTA Article 1131(2) provides: 'An interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section.'

[23] See: Notes of Interpretation of Certain Chapter 11 Provisions (NAFTA Free Trade Commission, July 31, 2001), http://www.international.gc.ca/trade-agreements-accords-commerciaux/disp-diff/NAFTA-Interpr.aspx?lang=en. ('FTC Note of Interpretation') URL last viewed on April 22, 2009. For a full recounting of the events leading up to the 2001 FTC Note of Interpretation and the reaction afterwards, see Ian Laird, 'Betrayal Shock and Outrage – recent Developments in NAFTA Article 1105', chapter in Todd Weiler (ed.), *NAFTA – Investment Law and Arbitration: Past Issues, Current Practice and Future Prospects* (2004).

[24] Numerous tribunals have confirmed that the accepted definition of 'international law' is set out in the Statute of the International Court of Justice Article 38(1) which provides that customary law is only one element of international law in addition to general principles and treaty law. As noted by Schreuer, The ICSID Convention: A Commentary, 2nd ed. (2009)('Schreuer') at 604, the Report of the Executive Directors referred to Article 38(1) in defining the term 'international law'. The NAFTA FTC Statement also raises the interesting problem that the three governments made a declaration that customary international law includes fair and equitable treatment and full protection security without any discussion or support for that proposition. This has of course resulted in a great deal of discussion by later tribunals and commentators.

law', it would not be unreasonable for such a term to be in accordance with the common and accepted definition of 'international law'. Certainly many critics, including the late Sir Robert Jennings, came to the conclusion that the so-called FTC 'interpretation' was merely a revision to the treaty without the bother of a broader re-negotiation process.[25] The FTC Note of Interpretation further begs the question as to what 'interpretation' in NAFTA Article 1131(2) actually means. Clearly, to the NAFTA Parties it did not mean the exercise set out by Sir Franklin above under the Vienna Convention or discussed in detail by Professor Wälde in his paper. However, even if the three NAFTA Commissioners had engaged in such an exercise, it is questionable whether they could have pointed to any context, and certainly not the objectives of the treaty, to support the exercise.

IV. Conclusion

The kind of 'interpretation' we observed with the NAFTA FTC Note of Interpretation is clearly the kind of opaqueness which Thomas Wälde sought to clarify.[26] When Humpty Dumpty says to Alice, 'it means just what I choose it to mean', he is similarly ignoring the multiplicity of meanings that can be derived from words, and their evolutionary nature. Humpty suggests that it is a simple question of being the 'master' of the words he uses. Later in his discussion with Alice, Humpty Dumpty suggests that it is merely an issue of paying the words their 'proper wage' to get them to do what one wants:

> Alice was too much puzzled to say anything, so after a minute Humpty Dumpty began again. 'They've a temper, some of them – particularly verbs, they're the proudest – adjectives you can do anything with, but not verbs – however, I can manage the whole of them! Impenetrability! That's what I say!'
>
> 'Would you tell me, please', said Alice 'what that means?'
>
> 'Now you talk like a reasonable child', said Humpty Dumpty, looking very much pleased. 'I meant by 'impenetrability' that we've had enough of that subject, and it would be just as well if you'd mention what you mean to do next, as I suppose you don't mean to stop here all the rest of your life.'
>
> 'That's a great deal to make one word mean', Alice said in a thoughtful tone.

[25] *Methanex Corporation v United States*, Second Opinion of Sir Robert Jennings (see http://ita.law.uvic.ca/documents/MethanexResubAmendStateClaimAppend.pdf. URL last viewed on April 22, 2009.)
[26] Wälde at 766-767.

> 'When I make a word do a lot of work like that', said Humpty Dumpty, 'I always pay it extra'.
>
> 'Oh!' said Alice. She was too much puzzled to make any other remark.
>
> 'Ah, you should see `em come round me of a Saturday night', Humpty Dumpty went on, wagging his head gravely from side to side: 'for to get their wages, you know'.

For the three NAFTA Parties, being the master of the scope of the term 'international law' and 'fair and equitable treatment' through the FTC Notice of Interpretation resulted in payment of a fairly high price for two reasons. Firstly, the various NAFTA tribunals whose awards the Note seemingly attempted to modify worked around the interpretation. Each tribunal agreed to follow it, but they enlarged somewhat on it. Each tribunal rejected the arguments of counsel for the NAFTA parties underlying the motivation for the Note that FET was a standard rooted in the 1926 Neer award of the Mexican Claims Commission.[27] These tribunals concluded that fair and equitable treatment was capable of evolving and had done so. As part of the discussion, the *Waste Management v US* NAFTA tribunal confirmed that fair and equitable treatment had evolved since 1926[28] and included as an element the question of legitimate expectations,[29] which has also been widely accepted outside of NAFTA as a central element of the overall standard.

Secondly, the declaration that FET is customary law appears to have resulted in numerous tribunals declaring that it was always so. There has been a heated debate in various subsequent arbitrations outside NAFTA about whether fair and equitable treatment is a treaty standard, and hence *lex specialis* and 'additive' to custom, or is part of customary international law. The issue was addressed by both the *Sempra* and *Enron* tribunals in 2007 leaving the door open to the possibility of the so-called 'additive' interpretation of the treaty version of the fair and equitable treatment clause.[30] Schreuer has also made a strong argument, citing

[27] *United States (L.F. Neer) v Mexico*, 4 R.I.A.A. 60 (1926) (Gen. Claims Comm'n.)(''Neer'').

[28] As noted by the Waste Management II Tribunal in April 2004: 'Both the Mondev and ADF tribunals rejected any suggestion that the standard of treatment of a foreign investment set by NAFTA is confined to the kind of outrageous treatment referred to in the Neer case, i.e. to treatment amounting to an "outrage, to bad faith, to willful 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".' *Waste Management Inc v Mexico*, Award, ICSID Case No ARB(AF)/00/3; IIC 270 (2004) 30 April 2004 ('Waste Management II') at para 93.

[29] Waste Management II at para 98: 'In applying this 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.'

[30] *Sempra Energy International v Argentina*, Award, ICSID Case No ARB/02/16; IIC 304 (2007) 18 September 2007 ('Sempra') at para 302, and *Enron Corporation and Ponderosa Assets, LP v Argentina*, Award, ICSID Case No ARB/01/3; IIC 292 (2007) 22 May 2007 ('Enron') at para 258.

Vascianne, F.A. Mann, Dolzer & Stevens, Muchlinski, and the UNCTAD study on FET, that the fair and equitable treatment standard is distinct and separate from the customary 'minimum standard of treatment'.[31]

However, this appears inconsistent with the holdings of numerous tribunals, including the *Saluka v Czech Republic* tribunal which attempted to put this issue to rest in 2006 stating that:

> …. [w]hatever the merits of this controversy between the parties may be, it appears that the difference between the Treaty standard laid down in Article 3.1 and the customary minimum standard, when applied to the specific facts of a case, may well be more apparent than real.[32]

Following the example of the *Azurix v Argentina* tribunal's 2006 decision, the *Duke v Ecuador* tribunal arrived at the same conclusion that whether termed customary or treaty based, 'the standards are essentially the same'[33] as did the *Rumeli v Kazakhstan* tribunal in 2008 when it stated that 'the treaty standard of fair and equitable treatment is not materially different from the minimum standard of treatment in customary international law'.[34]

Schreuer has posed a note of caution concerning this equating of the content of FET and the minimum standard – that it is having the opposite effect of those who seek to restrain the development of international law. As observed by Schreuer:

> The insistence that FET is identical with customary international law may well have an effect that is the opposite of what is intended by those who advocate this identity. It will not restrain the development of the FET standard. More likely, the consequence of that position will be to accelerate the development of customary law through the rapidly expanding practice on FET clauses in treaties.[35]

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[31] CH Schreuer, 'Fair and Equitable Treatment (FET): Interaction with other Standards' (September 2007) 4:5 *Transnational Dispute Management* ('Schreuer (2007)') at 10-11.

[32] See *Saluka Investments BV v Czech Republic*, Partial Award, Ad hoc—UNCITRAL Arbitration Rules, IIC 210 (2006) 17 March 2006 ('Saluka') at para 291.

[33] *Duke Energy Electroquil Partners and Electroquil SA v Ecuador*, Award, ICSID Case No ARB/04/19; IIC 333 (2008) 12 August 2008 ('Duke') at para 337, citing *Azurix Corp v United States*, Award, ICSID Case No ARB/01/12; IIC 24 (2006) 23 June 2006 ('Azurix') at para 284.

[34] *Rumeli Telekom AS and Telsim Mobil Telekomikasyon Hizmetleri AS v Kazakhstan*, ICSID Case No ARB/05/16; IIC 344 (2008) 21 July 2008 at para 611. A few days earlier in July 2008, the *Biwater v Tanzania* tribunal accepted the same proposition stating that: '… as found by a number of previous arbitral tribunals and commentators, that the actual content of the treaty standard of fair and equitable treatment is not materially different from the content of the minimum standard of treatment in customary international law.' See: *Biwater Gauff (Tanzania) Ltd v Tanzania*, Award, ICSID Case No ARB/05/22; IIC 330 (2008) 18 July 2008 at para 592 citing Saluka, CMS and Occidental in support.

[35] Schreuer (2007) at 17.

When Humpty Dumpty said 'impenetrability' to Alice, he meant that he had had enough of his discussion on the meaning of words and interpretation. However, as Thomas Wälde showed in his unique and penetrating manner, this is a question that does not give to easy answers or a simple formula. A man of no small ambition, in his own conclusion on these issues he advocated that

> The ultimate aim should be to facilitate the emergence of an international common law of investment arbitration – as if a world investment code existed….The goal cannot be full coherence; that is an aesthetic rather [than] a realistic goal. Coherent systems can only be those that are artificial, inward-looking, frozen in time and without relation to the outside world. It rather should be a reasonable and realistic degree of 'path coherence', that is, a gradual and cautious evolution which draws its legitimacy from a style of interpretation that is and appears to be reasonably faithful to the authoritative text.[36]

As a result of the many efforts of Thomas Wälde, we have now been set on this path. The 'particular challenges of interpretation of investment treaties before international tribunals' is confronting us and it is now up to those who follow to rise to Thomas Wälde's challenge to provide clarity in the face of confusion.

[36] Wälde at 51.

Thomas on the Formation of International Arbitral Tribunals: 'The Conversation'

Michael McIlwrath*

We recorded late into the night. As is often the case when you put together people who find what is in the parentheticals more interesting than the surrounding text, Thomas I did not strictly follow our plan of making a short and focused audio interview about how parties go about appointing the chair of an arbitral tribunal. Instead, we tended to digress even within our own digressions. But it was consummate Thomas that he was generous both in his hospitality in putting me up in his home for the night and his willingness to share candid opinions about international arbitration practices.

When I learned the tragic news of Thomas's untimely death just a few weeks after our session, I published an initial portion of his interview, on successful arbitration advocacy, *International Dispute Negotiation (IDN) 47: Thomas Walde: Advocacy in International Arbitration*. The remainder of the material was then edited into three self-contained interviews about 'Appointing Arbitral Tribunals', culminating in 'The Conversation,' an attempt to recreate the informal discussion between parties and arbitrators assessing candidates for chair of an arbitral tribunal:[1]

> IDN 67: Arbitral Tribunals, Part I of III: Tribunal Dynamics
> IDN 68: Arbitral Tribunals, Part II of III: Identifying Candidates for Chair
> IDN 69: Arbitral Tribunals, Part III of III: The Conversation

I am pleased that thousands have now been able to download and listen to Thomas speaking his views on topics that are as critical to international arbitration as they are absent from most texts on the subject. At one point during the interview, Thomas opined that he had always felt that the most valuable information about the practice of international dispute resolution could not be found in textbooks and treatises on the subject,

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[1] The International Dispute Negotiation (IDN) podcasts, including the Wälde interviews, are available for free downloading in the iTunes Music Store by searching for 'arbitration podcast' and at the CPR Institute website www.cpradr.org.

but in the minds and opinions of its practitioners. His interest and one of his aims, he said, was to reveal for others 'what lay underneath the emperor's clothes', embracing subjects that might have appeared politically incorrect or unpalatable to some.

Thomas had been an informal mentor and friend for some years, always encouraging me (as he had others) to share what I could of my own experiences with and views about international arbitration. In fact, it was through the privilege of knowing him that I first had the idea of conducting audio interviews with leading dispute resolution professionals around the world. Our debates in his public forum, OGEMID, and our many private exchanges via e-mail and occasional meetings in person imparted a desire to probe beneath the surface of articles and books and try to reveal on how dispute resolution really gets done in practice.

So at one point in 2007, I began recording informal conversations with dispute professionals as I travelled for work in different countries, with no idea what I would ever do with these interviews. One of the first people I contacted was Thomas, who suggested we could meet at his home to record if ever I was travelling to my company's offices in Aberdeen, Scotland, which was not far from where he lived.

It took time to find a match in our schedules, due in part to the fact that Thomas was also completing his qualifications to become a barrister and spending time in both London and St. Andrews, as well as his various other activities as counsel and arbitrator. At one point we intended to meet up when he was vacationing in southern Tuscany, not very far from where I live. This time, however, my own travel and other commitments intervened and instead of an interview, I received running commentary on Thomas' vacation. It had a striking similarity to his energetic professional life. This summary of the last day of his holiday is typical: 'walked from Rocchette di Fazio to Roccalbenga, 2.5 hours, up and down. Beautiful walk though I did get lost in the beginning. Both places amazing. In Roccalbenga, I missed a bus, no taxi, hitchhiking for older men clearly does not work so I had to walk all the way back and arrived utterly exhausted – but both very intriguing places. I am now buying all sorts of special hiking equipment. My main mistake was not enough water, I should have had re-hydration salts – even more important and finally my NYC bought sneakers got me blisters. But these places up the hill from Saturnia are all very interesting – as is Pitigliano and Sovano and the Cavone tuff-cut burial roads of the Etruscans…'. We missed each other on other occasions and locations, each one with a colourful description from Thomas about the landscape and his adventures in it.

When we finally did get together to record, I travelled to his home exactly as Thomas had initially suggested. In the meantime, I had found a use for the audio recordings, which was to publish them through the New York-based non-profit organisation, the International Institute for Conflict Prevention and Resolution (CPR). CPR kindly offered to issue the interviews as 'podcasts', recordings that could be downloaded for free as mp3 files for listening on computers and portable audio devices. I settled on the name 'International Dispute Negotiation' because it captured what Thomas and I had often discussed about the dispute resolution process being heavily influenced and determined via *negotiation* that occurs at all levels, for example internal negotiations within a large organization when a dispute arises, external negotiations between the different parties to a dispute, formalistic negotiations between parties and arbitral tribunals, and informal negotiations among the members of a tribunal.

For our interview, the topic we decided to record was a form of negotiation that can take place between a party representative and the arbitrator who has recently been appointed. We had discussed this idea over dinner at St. Andrews, at a Bangledeshi restaurant that Thomas liked and, invoking his network of connections, told me that another international arbitration professional, Arif Hyder Ali, originally from Bangledesh, had given high marks.

After dinner, we went to Thomas's home and I set up my microphones in his study, on a stack of black-covered arbitration filings from what he said was a significant case that had been resolved some years before. (Thomas mentioned in passing that the filings had been submitted by counsel to one of the parties, on the issue of document forgery). As it was the middle of the night when we finished recording, he generously put me up in his family's spare bedroom. He showed me how to make myself breakfast as I was leaving early in the morning to teach a course he had organized, and he warned I would probably not see him. Indeed, I never did again.

Our resulting three-part audio interview is Thomas speaking his mind on a topic that anyone involved in international arbitration would agree is the most critical: the formation of the arbitral tribunal, and how parties and arbitrators share information and make decisions about who to appoint.

Part I: Tribunal Dynamics. This is Thomas on his experiences with tribunals working together and the dynamics that might concern parties when making appointments, such as the risks/advantages of one versus three arbitrators, the benefits and risk of a strong chair,

and an innovative idea for institutions to offer 'standing tribunals' of arbitrators who are known to work together well. While I do not share Thomas's view that the value of having 'wing' arbitrators will usually outweigh the additional cost and time they impose (and he knew that we disagreed), listeners can hear, in Thomas's own voice, a strong defence of the dynamics of three decision-makers working together instead of one working alone.

Part II: Identifying Candidates for Chair. In this, Thomas provided his views on what parties should consider when appointing a chair in an international arbitration, and explained how he conducted his own due diligence on arbitral candidates. He quickly dismissed as overly simplistic whether a party should prefer an arbitrator from a common law or civil/continental background, and instead ventured into politically volatile areas such as gender and age considerations. Thomas's fondness for potentially 'taboo' subjects in the field of international arbitration is apparent here.

Part III: The Conversation. What ended up being the third instalment was what was originally intended to have been the entirety of our recording. The idea was to have a form of a role-play, with me as the party representative and Thomas as the co-arbitrator who had just been appointed. We would engage in the 'conversation' that takes place when a party representative and a nominated arbitrator review candidates for chair. We decided to base our discussion on real arbitrators. Although no names are mentioned, there were nonetheless moments when Thomas started to provide information about a certain candidate and then suddenly said, 'switch off the microphone' so he could give an even more candid assessment. Rather than deleting these instructions in the edited version of the interview (I did turn off the recorder), I decided to keep them because they underscore the delicate nature of 'The Conversation' and the fact that there are different levels of candour. It is one thing to share what one knows (or has heard) about a candidate with a colleague with whom intimate details of family lives and recent vacations are exchanged, and another to disclose information to an unfamiliar party or co-arbitrator in the course of discussing an appointment. "Turn off the recorder" is its own message about the practice of international arbitration. Thomas was aware that the uneven distribution of information about arbitrators handicaps the entire profession. Despite being advantaged through his own privileged access, he supported steps that would lead to greater transparency and a reduced need to rely on personal relationships and other informal channels of sharing information.

Rather than describe further what Thomas had to say about these subjects, I would refer readers to the recordings themselves, and Thomas, in his own voice.

Bifurcation of Title in International Oil & Gas Agreements

A. Timothy Martin*

I. Introduction

Owners of oil and gas rights often want to transfer all or part of their rights and obligations to other parties. They transfer these rights and obligations for a number of reasons; including to raise capital and to spread risk. They use different kinds of contracts to carry out such transfers; such as farmout, participation, swap and transfer agreements. They employ a number of legal mechanisms in these contracts to effectuate these transfers; one of which is the splitting or bifurcation of title in the oil and gas rights.

Bifurcation of title results in the splitting of the oil and gas rights into a 'legal' interest or title and a 'beneficial' interest or 'equitable' title. Title to any property, including oil and gas rights, is normally defined as the '… union of all elements (as ownership, possession, and custody) constituting the legal right to control and dispose of property'.[1] Legal title is '… title that evidences apparent ownership but does not necessarily signify full and complete title or a beneficial interest'.[2] It is the title that is usually registered with and formally recognized by a government. Equitable title is '… title that indicates a beneficial interest in property and that gives the holder the right to acquire formal legal title'.[3]

In an oil and gas transaction, such as a farmout agreement, a holder of the oil & gas rights may split the title into a legal title and a beneficial interest and subsequently transfer the beneficial interest (but not the legal title) to a transferee at the time of the transaction. The transferor usually holds the title in trust until the transferee meets certain, specified conditions; at which time the beneficial interest is usually converted into a fully recognized legal title in the oil and gas rights. Before bifurcating title in such transactions, parties need to be aware that the risk associated with such title bifurcation can vary widely depending on the jurisdiction where the oil and gas rights are issued and governed.

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[1] *Black's Law Dictionary*, 1622 (Bryan A. Garner ed., 9th Edition, West 2009).

[2] ibid at 1622.

[3] ibid at 1622.

II. Ownership and Applicable Law of Oil & Gas Rights

The original ownership of oil and gas rights is held and granted by governments in most countries in the world:

> Virtually all mineral ownership regimes are based on the jurisprudential theory of state sovereignty. The sovereign of a defined geographical area has exclusive legal dominion over the area, including its natural resources. … the most common global regime places ownership of minerals in the government… Energy resources… are subject to the government-ownership regime in virtually all countries except for North America. Today private ownership of all types of natural resources is possible only in the United States, Canada, and perhaps a few other countries. Even in the United States and Canada, the bulk of mineral reserves is owned by the government.[4]

The governments of those countries establish and determine the legal basis on which those rights are granted and assigned. When governments issue and grant a host government contract (HGC), such as a production sharing agreement (PSA), risk service agreement (RSA) or a lease/licence under a tax/royalty system to an international oil company (IOC) or a consortium of IOCs, they transfer the rights and obligations under their HGC to the IOCs pursuant to the law stated in that HGC or under the umbrella of the country's hydrocarbon law. It is therefore that contract and that law that determine the rights and obligations granted to the IOCs and the legal basis upon which the IOCs can make future assignments of those rights and obligations.

III. Split Title in Oil & Gas Agreements

In North American jurisdictions, grantors of oil & gas rights often split the title they grant. Even if the original grantors of the oil & gas rights do not do so, grantees sometimes subsequently bifurcate the title granted to them in the assignments that they make to third party assignees.

The title to oil and gas rights can be split in many different ways. Government grantors in North America often split the title by the type of mineral rights granted; e.g., oil, gas, coal, associated gas, oil sands, methane, etc. They also can split the title at the top or bottom of a particular geological formation or by the depth a well is drilled. When grantees of such oil and gas rights split the title in their subsequent assignment documents, they normally bifurcate it into a 'legal' title that is registered in some form of government registry and a 'beneficial' title

[4] EE Smith, 'World Energy Resources: Ownership, Control & Development', in *International Transactions* at 28 & 38 (EE Smith et al. eds., Rocky Mountain Mineral Law Foundation, 2nd ed., 2000).

that is held in trust by the assignor. This title bifurcating mechanism is commonly used in farmout agreements in North America. This legal practice has migrated into international oil & gas agreements. However, many countries' legal systems (particularly civil law jurisdictions) make no distinction between a 'beneficial' interest and a 'legal' title. One has to look to various sources to determine the legal validity of this practice.

Most of the publicly available case law on oil & gas transactions and agreements comes from U.S. (primarily Texas), Canadian (primarily Alberta) and English courts. These cases (including those concerning farmout agreements and title bifurcation) deal with disputes arising from O&G operations in their own domestic jurisdictions. International disputes over oil & gas agreements are mostly decided by international arbitration tribunals, which reflects the dispute resolution forums chosen in those agreements.[5] International arbitration awards are not widely available in the public domain. Therefore, the best way of determining what is normally included in those international agreements and what is considered best practice is to look at the model contracts developed by the industry.

Model contracts are developed by industry organizations over many years and reflect commonly accepted industry practice. They provide a good starting template for companies negotiating such transactions. They are drafted to be flexible enough to allow the parties to pick and choose the alternatives and options that work best for them.[6] The relevant international model farmout agreement and joint operating agreement (JOA) for international transactions are those that have been developed by the Association of International Petroleum Negotiators (AIPN). The AIPN issued three versions of its model JOA in 1990, 1995 and 2002 and is presently drafting a new version. It issued only one version of its model farmout agreement in 2004.

IV. Farmout Agreements

IOCs will often raise capital for exploration work programs by finding joint venturers through a farmout. This helps them spread both the

[5] The 2002 AIPN Model JOA drafting committee sent a list of questions to all AIPN members asking them how they used the existing JOA and what revisions would be most beneficial. The survey confirmed that few disputes arose under the 1995 model JOA, that international arbitration was the preferred forum and that English law was widely chosen (with Texas and New York law being chosen less often than once thought). See P Weems and M Bolton, 'Highlights of Key Revisions – 2002 AIPN Model Form International Operating Agreement' (2003) 6 *Int'l Energy L & Tax'n Rev* 169, 171.

[6] See AT Martin, 'Model Contracts: a Survey of the Global Petroleum Industry', Vol 22 No 3 *Journal of Energy & Natural Resources Law*, at 281 (August 2004) for a more complete analysis of model contracts in the international O&G industry.

risk and cost associated with exploration. The following explanation describes how a typical oil and gas farmout works in the United States:

> [A farmout is an] agreement by one who owns drilling rights to assign all or a portion of those rights to another in return for drilling and testing on the property. The individual or entity that owns the lease, called the 'farmor' or 'farmoutor' is said to 'farm out' its rights. The person or entity that receives the rights to drill [is] referred to as the 'farmee' or 'farmoutee'.... The primary distinction between an operating agreement and a farmout agreement is functional. A farmout agreement is a contract by which one party earns an interest in an oil and gas lease owned by another, while an operating agreement is entered into to define the rights and duties of parties who already own joint interests in a lease or a drilling unit and to combine those interests for joint operations. Another distinction is that the farmee 'carries' the farmor for all or a portion of the drilling costs in a farmout, while the parties to an operating agreement generally share the costs of drilling. Typically, those who enter into a farmout agreement also will execute an operating agreement to govern their rights after they have performed the farmout contract.[7]

Farmouts are usually structured in one of two ways with regards to when a farmor assigns a part of its interest to the farmee:

> Farmout agreements traditionally have taken the form either of an agreement to convey or a conditional assignment. The essential difference in the two is the point in time when the farmee acquires an interest in the farmed-out property. When the farmout is in the form of an agreement to convey, the farmee obtains its rights only if it performs the conditions made prerequisite by the contract. When the farmout is in the form of a conditional assignment, the farmee obtains an interest in the farmed out property when the agreement is made, subject to an obligation to reconvey or to automatic termination if the conditions subsequent are not performed.[8]

Parties use the technique of bifurcating title in agreements to convey. The farmor conveys an initial beneficial interest to the farmee with the right to earn legal title upon fulfilling the conditions in the farmout agreement.

The traditional use of the term 'farmout' is normally applied to a 'drill to earn' arrangement. What normally happens in the North American O&G industry is that the farmee in its own capacity undertakes to either shoot seismic or drill a well or several wells (or both) on the farmor's O&G lease. Once the farmee completes that undertaking, it has earned its interest in that O&G lease. The farmee usually continues to operate

[7] John S Lowe, 'Analyzing Oil and Gas Farmout Agreements' (1987) 41 *Sw. L.J.* 759, 763-64.
[8] ibid at 796.

that lease; rather than the farmor re-assuming its former operator role. These types of arrangements are relatively straightforward in North American operations where the land registry systems are efficient and government approval is not required for the transfer of mineral rights.
The international O&G industry also uses the term 'farmout', but the mechanics of the transaction are handled differently. Quite often, the farmee agrees to provide the funds to the farmor so that the farmor can carry out the agreed upon operations; while the farmee retains the ability to approve or not approve what the operator (i.e., the farmor) does. This reflects the legal, political and operational challenges encountered in the international O&G business. Most governments want to control who manages their national resources and Ministries of Energy are often reluctant to accept a new party. As a result, many international farmout agreements include a condition that government approval must be obtained for an assignment of rights as required by the HGC.

V. Government Approval

The AIPN model farmout agreement is illustrative of what is typically found in international O&G farmout agreements and HGC title transfers. It is drafted for a relatively simple scenario in the exploration phase of a PSA, RSA, or Concession License. The consideration provided by the farmee can be either a work program, sometimes called a 'drill to earn', or cash. It also provides for the option to pay a premium or 'promote' which occurs in many farmouts. The model contract provides for the assignment of an interest by way of a separate assignment document. This assignment document can either be executed along with the farmout agreement and submitted to the government for approval shortly after signing the farmout agreement, or alternatively, the assignment document can be executed after satisfaction of the conditions precedent and government approval being obtained. If the first alternative is chosen, a mechanism is built into the agreement to unwind the transaction if the conditions are not met. This is quite often done by having the farmee grant the farmor a power of attorney to cancel the assignment after the fact. Alternatively, many farmout agreements simply provide that the parties will obtain the government's approval as required under its HGC or hydrocarbon law.

The AIPN model farmout agreement recognizes the difficulty of obtaining government approval to an assignment by providing an optional provision for the farmee to terminate the agreement at that time without any further obligation or liability. The guidance notes to the model explain the impact of failing to obtain the necessary government approvals:

> In some jurisdictions, a failure of the Government to approve within a specified amount of time may be deemed to be approval or rejection of the proposed Assignment. In some jurisdictions, it is possible for Farmor to hold the interest of the Farmee in trust. However, it is likely that the establishment of a trust implies a transfer and could be considered a breach of Contract for not obtaining government approval. In addition, the legal regimes of some jurisdictions may not recognize a beneficial trust. Finally, there may be tax consequences associated with a trust.[9]

In July 2004, the drafting committee for the AIPN model farmout agreement presented the final approved AIPN Model Farmout Agreement to the attendees of the AIPN's annual Model Contracts Workshop, which is the primary venue for the development of its model contracts. A Question & Answer session was held that captured industry wide concerns and best industry practices with regards to international farmout agreements and the related assignment of interests under HGCs:

> Comment: In some jurisdictions, the Assignment document cannot be signed until governmental approval has been obtained.
> Comment: An attendee cited one case in Africa where government approval of an assignment was not required but was sought.
> Q: Is there an equitable assignment if the Farmout Agreement is signed but the Parties do not yet have government approval?
> A: Possibly.
> Q: If the government consents to an Assignment, don't we still need a document referencing the agreement of the Parties?
> A: An equitable interest could be created but this would only be effective between the Parties.
> Q: If the Host Government requires approval prior to making an assignment, then the Government could terminate your contract if a party made an assignment without prior government consent.
> A: Good Point.
> Q: Could you get government approval for an assignment subject to certain conditions, i.e., reassignment if not comply?
> A: Uncertain but possible.[10]

The concerns raised in this industry dialogue underline that parties must obtain timely government approval for their farmout if such approval is required; failing which the HGC may be at risk.

Even though bifurcation of title regularly occurs in North American farmout agreements, this title transfer technique is not commonly used in international farmout agreements because of the risk associated with not getting the necessary government approval at the beginning of

[9] *AIPN Model Farmout Agreement User Manual*, 4 (2004).
[10] Papers from AIPN 2004 Model Contracts Workshop available at www.aipn.org

the transaction. Parties can reduce, if not eliminate, this legal risk by obtaining the government's prior written approval to an assignment while imposing an obligation on the farmee to reconvey or provide for automatic termination of the farmout agreement if the farmee fails to fulfill its obligations. The reason for favouring this more common practice in international farmout agreements is simple. Even though there may be a problem getting the farmee to reconvey its interest back to the farmor if it fails to complete its earning obligations, it is better to get the government's approval to the transfer at the beginning of the earning period rather than at the end in order to meet the requirements of the HGC or hydrocarbon law. No IOC wants to have a dispute. But if a farmor has to pick a fight between an uncooperative farmee or a displeased government, the farmee is a better choice.

VI. Support for Bifurcation in International O&G Agreements

If parties to an international farmout agreement choose to split the interest in a HGC into a 'legal' title and a 'beneficial' interest and then transfer the beneficial interest to the farmee, such actions could imply a transfer of the rights and obligations under the HGC. Where it is and where a required government approval has not been obtained, such title bifurcation and transfer may not be recognized by the government and, more significantly, may be considered a breach of the HGC or the hydrocarbon law.

In response to such allegations, parties that bifurcate the rights and obligations in HGCs and enter into a farmout agreement without obtaining prior government approval cite a number of legal justifications for their actions.

A. Governing Law of Farmout Agreement

The parties to an international farmout agreement usually choose a governing law for their contract with which they are familiar and comfortable. That law is most likely the law of their home jurisdiction and not the law of the country where the HGC is granted. If that chosen law is from the United States, Canada or England, it would recognize the concept and validity of title bifurcation. The farmor and the farmee would therefore want to rely upon this law to declare that the bifurcation and transfer of title under their farmout agreement were legally valid.

Even though this law is the proper law to apply in any dispute between the farmor and the farmee concerning their farmout agreement, it is not the correct law to apply in determining whether the rights and obligations under the HGC were properly assigned or even assigned at

all. The only law that can be applied in determining whether a proper assignment of an interest under the HGC was or could be completed is the law in the HGC or the hydrocarbon law that granted the original title. That law is usually the law of the host government and it is that law that will determine the requirements for transferring interests under the HGC.

In addition, neither the government, its designated ministry nor its national oil company (NOC) can be bound by a farmout agreement and the law that governs that farmout agreement if they are not parties to that farmout agreement. Invariably, they are not.

B. International JOAs Recognize Bifurcation

The most significant and long term contract used amongst IOCs in the upstream O&G business is the joint operating agreement (JOA). It sets out the fundamental and overarching relationships in a joint venture consortium from the initial exploration to the ultimate production of hydrocarbons. Proponents of title bifurcation in international O&G agreements argue that the practice is well recognized and is customarily included in international JOAs; as shown in Articles 8.4 and 13.7 of the AIPN Model JOA,[11] which is the industry standard for international JOAs.

Article 8.4 (F) of the Model JOA reads: 'In the event all Government approvals are not timely obtained, the Defaulting Party shall hold the assigned Participating Interest in trust for the non-defaulting Parties who are entitled to receive it'. Article 13.7 of the Model JOA states: 'If the Government does not approve a Party's withdrawal and assignment to the other Parties, then the withdrawing Party shall at its option either (1) retract its notice of withdrawal by notice to the other Parties and remain a Party as if such notice of withdrawal had never been sent or (2) hold its Participating Interest in trust for the sole and exclusive benefit of the non-withdrawing Parties with the right to be reimbursed by the non-withdrawing Parties for any subsequent costs and liabilities incurred by it for which it would not have been liable, had it successfully withdrawn'.

These articles do not provide for the bifurcation of title or speak of 'legal title', 'equitable title' or 'beneficial interest'. Instead, these articles attempt to deal with an unplanned, difficult situation where the remaining parties in the JOA and the HGC are forced to deal with a party that is not paying its share of the costs. These articles do not apply to the

[11] Article references are for the 2002 AIPN Model JOA. There are similar articles in prior AIPN models.

situation where a party to a HGC is considering transferring a part of its interest under a farmout agreement to a new third party. These are situations where the JOA parties request the government's approval to the transfer of an existing party's interest that is either defaulting or withdrawing and the government fails to provide it. These are not of the JOA parties' making. The parties are simply attempting to set up a trust arrangement where they have limited, if no options. And the party that has to hold its interest in trust under these two articles is a party (the defaulting or withdrawing party) that already holds legal title in the HGC.

Even though the AIPN Model JOA does not mention the bifurcation of title, it does recognize the importance of obtaining government approval prior to transferring an interest in a HGC. Article 3.2 (B) of the AIPN Model JOA provides that a transferee is not entitled to any rights under the HGC and JOA until Government approval has been obtained and the consent of the other Parties has been received: 'If a Party transfers all or part of its Participating Interest pursuant to the provisions of this Agreement *and the Contract*, the Participating Interests of the Parties shall be revised accordingly'[12] (emphasis added). As a co-chair of the 1990 model drafting committee has pointed out: '… the transfer document is not just an assignment, it is rather a novation that must be executed by all Parties and the host government'.[13]

C. Privity of Contract

Parties that bifurcate title without first obtaining a required government approval have argued that the government need not worry since it only has to look to the original HGC contractor for the fulfillment of its obligations. They point out that a farmee with no legal title does not take the place of the contracting party and does not in any way reduce the government's ability to have the HGC obligations fulfilled or to seek redress from the contractor if they are not fulfilled. As long as the farmee is not a party to the HGC, the farmee cannot exercise any rights directly against the government and therefore the government is not put at risk of having to deal with an unknown party. The underlying argument is that neither the farmor nor the farmee can be in breach of the HGC since the HGC obligations are being fully met. It does not matter where the funds are coming from or how decisions are being made under the farmout agreement or the JOA. The government only has privity of contract with the HGC contractor (i.e., the farmor) and

[12] The AIPN Model JOA defines 'Contract' as the HGC in Article 1.14 and the initial recitals of the JOA.

[13] Andrew B. Derman, *Model Form International Operating Agreement: An Analysis and Interpretation of the 1995 Form*, ABA Monograph Series Number 23, 43 (1997).

not the farmee, and therefore the government need only look to the named contractor. Since the work obligations under the HGC are being met, ergo the bifurcation of title and the agreement to convey under the farmout agreement must be valid.

The problem with this argument is that many HGCs and hydrocarbon laws specifically require prior government approval to the transfer of an interest in a HGC and they do not recognize or allow for the unauthorized bifurcation of title. Many governments have decided for their own policy reasons to restrict who operates or invests in their country. These restrictions are intended to prevent undeclared transactions in which the contractor has agreed to undertake joint operations with an unknown third party, while continuing to hold itself out to the government as the sole party involved in operations. It therefore does not make sense to allow a contractor to invoke privity of contract as an argument to avoid the very restriction against such transactions. If that argument had any substance, there would never be a situation in which the sanction could apply.

D. Joint Liability

Another argument put forth by parties that bifurcate and transfer title under farmout agreements without obtaining prior government approval is that a farmee does not undertake any liability under the HGC and therefore can have no obligation towards the government or the NOC under the HGC, and vice versa. They point to the standard language in international JOAs that expressly disclaims joint and several liability amongst the parties. This standard language is found in Article 14.1 of the AIPN Model JOA. That language reads: 'The rights, duties, obligations and liabilities of the Parties under this Agreement shall be individual, not joint or collective. It is not the intention of the Parties to create, nor shall this Agreement be deemed or construed to create, a mining or other partnership, joint venture or association or (except as explicitly provided in this Agreement) trust'.

The language in Article 14.1 of the AIPN Model JOA and thus in many international JOAs is an attempt to limit the joint and collective liability of JOA parties against the default of one of the parties in the agreement and the tax consequences of creating joint ventures or partnerships. This kind of provision is almost universally ignored by governments around the world. Governments take the position that since they are not parties to these agreements, they are not subject to their contractual provisions. Governments also consistently take the position that the only thing that matters in establishing liability in such circumstances is their own law and regulations, regardless of whether a party has failed to enter into

a contract with the government. Those laws and regulations usually impose joint and several liability on the parties.

Interestingly Article 14.1 states that the parties are not creating a trust, even though Articles 8.4 and 13.7 of the Model JOA say otherwise. This article also does not mention bifurcating title or the creation of legal or equitable titles and therefore does not lend any support to the use of bifurcation in international JOAs or farmout agreements.

E. Farmee Does Not Influence or Impact HGC

The final justification for the legitimacy of title bifurcation is that a farmee cannot direct either the day to day management or long term development strategy of a HGC under the terms of an international farmout agreement and JOA. The reasoning behind this argument is that a farmor, as the sole party to the HGC and as the sole operator under the JOA, retains final decision making authority over a block's operations. If that were the case, a farmee cannot influence or impact the long-term objectives of the HGC, the daily operations on a block or the completion of the HGC obligations.

It is normal practice in international JOAs for an operating committee to delegate substantial authority to an operator. That is what operators are expected to do. But that does not diminish a non-operator's ability to approve or not approve development plans, work programs and budgets, relinquishments or amendments of a HGC under a JOA. An operator usually prepares the work programs and budgets and long term development strategy. But it is the operating committee that ultimately approves and provides the funds for those work programs and budgets and long term strategies. This is clearly stated in Article 5.2 of the AIPN Model JOA, which is common language in many international JOAs: 'The Operating Committee shall have the power and duty to authorize and supervise Joint Operations that are necessary or desirable to fulfill the Contract and properly explore and exploit the Contract Area in accordance with this Agreement and in a manner appropriate in the circumstances'. All important decisions of the Operating Committee are made according to the pass mark set in Article 5.9 of the AIPN Model JOA: '… all decisions, approvals and other actions of the Operating Committee on all proposals coming before it shall be decided by the affirmative vote of – or more Parties which are not Affiliates then having collectively at least – percent of the Participating Interests'.

What matters is not whether the farmee (and non-operator) is in charge of operations, but whether it is able to participate in an operating committee whose decisions the operator is obliged to carry out. If the

farmee's vote is required to meet the designated pass mark, then the operator can only carry out Joint Operations with the concurrence of the farmee. The only conclusion that can be reached is that a farmee in an international farmout agreement and JOA does in fact participate in decisions that directly impact the strategy and daily operations in a HGC block.

VII. Conclusion

The law that applies to the transfer of an interest or title in a HGC is the law provided in the HGC or in the hydrocarbon law of the country granting the original title. Even though bifurcation of title is regularly used in farmout agreements in North America where it is legally recognized and valid, that is not always the case in international farmout agreements in other parts of the world. If the HGC or hydrocarbon law does not recognize the bifurcation of title and requires prior government approval of a title transfer in the HGC to a third party, there is significant risk in not obtaining prior written government approval to a farmout agreement and the bifurcation and transfer of title. This could possibly result in a breach of contract and the unilateral termination of the HGC by the government. The facts of each case will determine the validity of a transaction; nevertheless, IOCs need to be careful in bifurcating title in international oil & gas agreements.

Investment Claims and Arbitrator Comportment

William W. Park*

I. The Context

Thomas Wälde had such a curious mind that any speculation about his favorite object of inquiry might best be left to the other side of eternity. Without doubt, however, arbitration of investment claims held a special place among the subjects that engaged his intellect. Such arbitration supplied what he called 'external adjudicatory discipline' to investor-state relations, enhancing the rule of law, human rights and cross-border economic cooperation.

The proposition that arbitration disciplines investment begs an inquiry into the forces that discipline the arbitrators themselves. *Quis custodiet ipsos custodies*? What standards constrain the comportment and mind-sets of those who make the decisions?

Often one hears that integrity is to arbitration what location is to the price of real estate: without it, other things do not matter all that much. Nowhere is that truism more significant than for investor-state proceedings, where arbitration's treaty basis means that one side (the government) will be bound to arbitrate in a comprehensive way that obviates the need for any contractual arbitration clause.

Students of history remember that claims related to mistreatment of a foreign investor traditionally were subject either to the home-court jurisdiction of the expropriating country or to the 'gunboat diplomacy' of the investor state's political and military influence.[1] In some instances, arbitration triggered by diplomatic pressure led to significant and controversial debates on legal theories about state responsibility.[2]

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[1] Although the legal use of force is now in the 21st century more circumscribed as a tool of foreign policy (see Article 51 of the United Nations Charter), the reality of military influence on international economic relations has not disappeared.

[2] For example, the '*Tinoco* Case' (named for General Federico Tinoco, a Costa Rican dictator who ruled between 1917 and 1919 after overthrowing that country's legitimate government) led to the elaboration of the 'odious debt' doctrine, which was revived in the context of Iraqi commitments contracted during the regime of Saddam Hussein. An award by William Howard Taft (who served as both President of the United States and Chief *Cont.*

In its early days, investor-state arbitration was largely a matter of contract,[3] with concession agreements serving as the foundation for arbitrators' power to hear investor claims for *de jure* or *de facto* expropriation.[4] During the past several decades, however, bilateral and multilateral treaties have given foreign investors an opportunity to arbitrate disputes even in the absence of any direct concession with the host state.[5]

The paradigm shift from contract to treaty means that arbitrator integrity has become even more vital to host state acceptance of arbitration as the normal vehicle to resolve investor claims related to expropriation and discrimination, particularly as such claims increasingly affect vital national interests such as the environment, taxation, and administration of justice. While consent remains the foundation of arbitral jurisdiction, government acceptance takes a blanket form through free trade and investment agreements, or even an investment statute.

Justice of the U.S. Supreme Court) upheld state succession with respect to governmental commitments (loans to the Royal Bank of Canada) but suggested that illegitimate obligations of an illegitimate government may nevertheless fail to bind following downfall of the illegitimate ruler. *Great Britain v Costa Rica*, reprinted in (1923) 1 *R. Int'l Arb. Awards* 369, and (1924) 18 *Am. J. Intl L.* 147. See also, Lee C Buchheit, G Mitu Gulati & R B Thompson, 'The Dilemma of Odious Debts' (2007), 56 *Duke L. Journal* 1201, suggesting that as a putative doctrine of international law, had it flown at all, 'odious debts' would have flown very low, 'far beneath the level of near-universal consensus required to make it a binding norm of international law'. See also, D C Gray, 'Devilry, Complicity & Greed: Transnational Justice & Odious Debt' (2007) 70 *Duke J. Law & Contemp. Probs.* 137; Tai-Heng Cheng, 'Renegotiating the Odious Debt Doctrine' (2007) 70 *Duke J. Law & Contemp. Probs*. 7; O Lienau, 'Who Is the "Sovereign" in Sovereign Debt?'(2008) 33 *Yale J. Int'l L.* 63; and B N Lewis, 'Restructuring the Odious Debt Exception'(2007) 25 *B.U. Int'l L.J.* 297. The doctrine of odious debts ('*dettes odieuses*') was formalized in 1927 by a former minister of Tsarist Russia then teaching law in Paris. See A N Sack, *Effets des transformations des états sur leurs dettes publiques* (Paris, 1927).

[3] Not all investment arbitration was contractual, however. In 1794, the so-called 'Jay Treaty' (named for its American negotiator John Jay) gave British creditors the right to arbitrate claims of alleged despoliation by American citizens and residents. See Treaty of Amity, Commerce and Navigation, London, 19 November 1794, U.S.–U.K., 8 Stat. 116. Under Article 6, damages for British creditors were to be determined by five Commissioners, two appointed by the British and two by the United States. The fifth was to be chosen unanimously by the others, in default of which selection would be by lot from between candidates proposed by each side. See generally B Legum, 'Federalism, NAFTA Chapter Eleven and the Jay Treaty of 1794' (Spring 2001) 18 *ICSID News*.

[4] Often investor-state arbitration takes place pursuant to an investment concession between host country and foreign investor. See eg, *LIAMCO v Libya*, 482 F. Supp. 1175 (S.D.N.Y. 1980); *vacated* 6 May 1981, D.C. Cir., No. 80-1207; *TOPCO/California Asiatic v Libyan Arab Republic*, 17 ILM 1, 29 (1978). Such investment arbitration pursuant to concessions is different, of course, from so-called 'mixed commissions' of the colonial era.

[5] See generally, C McLachlan, L Shore & M Weiniger, *International Investment Arbitration: Substantive Principles* (2007).

A treaty-based standing offer to arbitrate gives foreign investors a direct right of action against the host state, exercisable as the occasion arises,[6] subject always to the conditions provided in the treaty or statute itself.[7] In some instances, there may also be an opportunity for government-to-government arbitration following reimbursement to investors under political risk insurance.

II. Critiques of Investor-State Arbitration

Investor-state arbitration has been a fertile ground for criticism related to arbitrator integrity. Some authors have written of 'The Businessman's Court' with the implication that arbitrators tend to favor claimant-investors in order to increase prospects of reappointment.[8]

A large part of the critique aims at the current 'party-selection' system, suggesting that arbitrators' desire for business leads to a systemic bias in favor of investors. Such pessimistic appraisals of arbitrators usually find themselves linked to a more diffusely negative commentary on investor-state relations, asserting a perceived malaise with respect to the fairness of arbitration itself.[9] Each of these two concerns will be addressed below.

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[6] Jan Paulsson has suggested the catch-phrase 'arbitration without privity'. J Paulsson, 'Arbitration without Privity' (1995) 10 *ICSID Review/Investment Law Rev.* 232. See generally, A Prujiner, 'L'Arbitrage unilatéral: Un coucou dans le nid de l'arbitrage conventionel?' (2005) *Rev. Arb*. 64.

[7] In one recently decided ICSID case, the tribunal rightly reminded us of the need for caution with respect to notions such as 'arbitration without privity'. See *Wintershall Aktiengesellschaft v Argentina*, Award, ICSID Case No. ARB/04/14, signed 8 November 2008 (Fali Nariman, presiding, with Dr Santiago Torres Bernárdez and Professor Piero Bernardini, co-arbitrators). Finding that the facts of that case did not permit the investor to invoke a so-called 'Most-Favored Nation' clause (allowing an investor invoking one treaty to benefit from more favorable provisions of another), the tribunal stressed (Award, at 97-98) that consent in writing remains the cornerstone of ICSID arbitration. The treaty's standing offer to arbitrate must be accepted on a case-by-case basis. Lack of privity at the beginning does not dispense with the requirement to perfect the agreement to arbitrate. Perfection occurs when a particular investor accepts that standing offer by filing a claim, and at that time must comply with the requirements of the treaty.

[8] See eg, G van Harten, *Investment Treaty Arbitration and Public Law* (2007), at 152-53. For investor-state dispute resolution, Professor van Harten advocates a public law model with tenured judges. Ibid at 175–84.

[9] See L T Wells & R Ahmed, *Making Foreign Investment Safe* (2007) 283-98. The authors criticize investor-state arbitration, *inter alia*, for what they see as its rigidity and lack of sensitivity to changed circumstances and public policy, as well as the effect of moral hazard in the form of arbitration awards that discourage investor analysis of the stability of their contracts. They then suggest reforms including *amiable composition* (disregard of law and contract in favor of what is 'fair and just'), more transparency in arbitration, a common law that relies on precedent and an appeals body to review awards. They then suggest that serious reforms will be resisted by 'the small group of lawyers who now dominate investment arbitration' in part because they 'resist making decisions based on criteria beyond the language of a contract' and fear smaller awards as 'a threat to their income'.

Cont.

A. Systemic Bias in Favor of Investors

One common line of argument posits that systemic 'incentives' push arbitrators to decide for investors. The argument seems to run as follows: arbitrators seek to promote growth of investor-state proceedings in order to get future appointments; efforts to promote arbitration translate into decisions that favor claimant-investors, particularly when the appointing authority is ICSID (International Centre for Settlement of Investment Disputes), a World Bank affiliate said by some critics to be structurally biased toward decisions that favor investors.[10] For reasons discussed below, neither evidence nor logic supports either the existence of such incentives or their operation in practice.

As a preliminary matter, inducements to pro-investor bias remain counterintuitive. Reputations tarnished by deviation from duty do not bring reappointment, at least when both host state and investor have a role in the process. Assuming rational arbitrators seek to enhance income, biased decision-making would be an odd way to do so, given that awards would be subject to review by either national courts (for lack of due process or violation of public policy) or before an *ad hoc* committee convened in connection with an ICSID proceeding.[11] Thus if arbitrator incentives operate at all in large international cases, they work to promote accuracy and honesty.

Although teenage boys may hope to attract adolescent girls by showing themselves dangerous and daring, no similar rule works for judges or arbitrators. Rumors of prejudice and partiality do little to enhance the credibility of professional decision-makers, who normally benefit from reputations for reliability and accuracy. Bad arbitrators exist, but their lack of integrity does them no favors.

Ibid at 298. Some of the conclusions will startle the thoughtful observer, particularly the suggestion that 'predictability of outcome' will follow the practice of looking 'beyond the language of a contract' and greater recourse to *amiable composition*.

[10] See G van Harten, *Investment Treaty Arbitration & Public Law*, 152-53 and 167-175. This theme is developed by Professor van Harten in 'Does a Perceived Structural Bias Undermine the Legitimacy of Arbitration?' in *Backlash Against Investment Arbitration* (forthcoming), where he makes reference to 'the incentives and pressures that arise from the arbitrator's insecurity of tenure'. His latter work begins with the affirmation, 'Investment treaty arbitration is characterized by an apparent bias in favour of claimants and against respondent states'. Later, the essay suggests that arbitrators have 'an apparent interest to interpret law in a way that facilitates or encourages claims… '.

[11] ICSID Convention Article 52(1) provides for award annulment where there was, inter alia, 'corruption on the part of a member of the Tribunal' or 'a serious departure from a fundamental rule of procedure'. Challenge to an arbitrator will be allowed as to individuals who do not meet the standards for Article 14, which requires that an arbitrator 'may be relied upon to exercise independent judgment'.

As a secondary matter, one might readily admit that a system of tenured international judges should be explored as a theoretically better system, as suggested in the 'public law' model advocated by Professor van Harten.[12] The difficulty, however, lies in finding a commercial appointing authority that would command worldwide confidence. The most realistic baseline against which to measure the present system is not a 'World Arbitrators Corps' appointed by a single universally admired institution, but rather a diffuse set of national courts staffed by judges perceived as even more partial (toward their appointing governments) than arbitrators constituted by a joint decision of the parties.

A third and even more compelling reason exists to impeach the plausibility of a theory hypothesizing pro-investor incentives. Without host state participation in bilateral investment treaties (BITs) and free trade agreements (FTAs), investment arbitration would take a very different aspect. Just as it takes two to tango, so it takes two countries to conclude a treaty. Investor-state arbitration succeeds only if the process appears fair to host-state as well as investor interests. Host states appoint as many arbitrators as investors, and a presiding arbitrator must be acceptable to both sides.

No 'Global Arbitral Authority' today commands general acceptance in the eyes of any sizeable number of economic players. In an international context, party input into the arbitrator selection process remains a condition for the litigants to feel comfortable with the legitimacy of the tribunal, and perhaps for acceptance of the treaty commitments in the first place.

The present base line against which to evaluate alleged arbitrator bias remains decision-making by judges beholden to national governments. It seems unrealistic to expect litigants to relinquish their traditional role in selecting arbitrators without a realistic alternative. Whilst ideals can be worth pursuing even if not fully realizable, the best would become the enemy of the good if pursuit of theoretical neutrality led to dismantling or dismissing the current system, which for all its faults suffers far less bias than its alternatives.

Debates on the propriety of the current arbitrator selection system often touch on what is referred to as 'transparency', a notion that includes public pleadings and open hearings. On occasion, the more titillating term *secrecy* is used to imply an aura of something untoward about arbitration, perhaps evoking the *omertà* or code of silence operating among criminal organizations in southern Italy. The assumption of such

[12] See Van Harten, supra, at 175–84. Although the work of Professor van Harten criticizes ICSID as an appointing authority, it does not seem to suggest any realistic replacement.

loaded language seems to be that secrecy is suspect, perhaps, because it breeds lack of accountability.[13] In any event, it is not clear who benefits from lack of publicity.[14] Host states themselves may resist the glare of publicity when an expropriation risks exposing political corruption or victimization of ethnic groups through unfair spoliation.

Assertions of systemic bias can detract attention from consideration of more concrete measures to promote arbitrator integrity. Thoughtful dialogue should focus on how to articulate and implement ethical principles that avoid the two principal paths by which arbitration may come into disrepute: (i) lax ethical canons that tolerate arbitrator prejudgment and hidden links to parties, and (ii) unrealistic rules that facilitate abusive arbitrator challenges designed to disrupt the arbitral process.

Dialogue on arbitrator integrity becomes more plausible if linked to the way arbitrators consider facts and legal arguments. Do cases suggest that arbitrators invent treaty requirements not apparent on the face of the convention, in a way analogous to the way some American judges find 'penumbra' rights in the United States Constitution? Does bias show in weighing evidence or granting requests for document production? Have arbitrators shut their eyes to discriminatory rhetoric from host state legislators in parliamentary exchanges?[15]

As mentioned earlier, institutional incentives to arbitrator bias can and do exist when arbitrators are taken from one particular industry.[16]

[13] See generally, 'Behind Closed Doors', *The Economist*, 25 April 2009 (Print Version) 63, reporting on the 'struggle' of an Indian lawyer named Ashok Sancheti who wished to receive publicity for his claim against the United Kingdom. For earlier debate on the subject, see also, A De Palma, 'NAFTA's Powerful Little Secret', *New York Times*, Sunday Late Edition, 11 March 2001, Section 3, at 1. In December 2001, an advertisement in the *Washington Post* attacked investment arbitration under the headline 'Secret Courts for Corporations'. Sponsored by Ralph Nader's 'Public Citizen's Global Trade Watch', the publication referred to arbitrators as judges whose 'identity can be kept secret indefinitely', *Washington Post*, 5 December 2001, at A-5.

[14] See N Rubins, 'Opening the Investment Arbitration Process: At What Cost, For Whose Benefit?' (2009) *Austrian Arbitration Yearbook* 483.

[15] Of course, smart people sometimes know how to mask their bias. This remains a fact of life no matter what the guiding principles on impartiality. Unless we establish a way to cut open an arbitrator's head to see what is really going on (and then put things back together again), the best clues to partiality lie in the things that actually have been said or written.

[16] In the United States, the Securities and Exchange Commission in the United States has issued directives to limit the role of arbitrators with substantial connections to financial advisors. The directives mandate that arbitrators who decide consumer disputes involving brokerage houses should not be drawn unduly from the ranks of stock brokers or their lawyers. Many of these cases fall to be decided under the auspices of the Financial Industry Regulatory Authority (FINRA), a self-regulatory body which in 2007 consolidated the dispute resolution for both the National Association of Securities Dealers (NASD) and the *Cont.*

Analogies from domestic arbitration do not always transplant well, however. When disputes address a specific sector of the economy, arbitrators should not be closely identified with the relevant industry. By contrast, when the distinction lies between the two broad categories of host state and investors, few potential arbitrators of any experience or ability will be able to avoid association with one group or the other. Most will have links with both.

Moreover, when the alleged enticements to bad behavior relate to the simple dichotomy between investor and host state, the domestic paradigm loses much of its force. As illustrated by the role of sovereign wealth funds, countries such as China (traditionally considered a host state) often invest in countries such as the United States (the investor state par excellence). Needless to say, incentives to 'repeat player' status can operate just as well for individuals known in the arbitration community to be regularly appointed by host states.

B. Disillusionment with the Process

The suggestion that arbitrator bias is driven by systemic incentives will dovetail into the current debate about whether investor-state arbitration continues to inspire general confidence.[17] The argument that public appreciation for investment arbitration has been dissipated rests on several factors, including increased political sensitivity and inconsistent results. Concern about arbitrator integrity constitutes one element in the mix of alleged malaise.

As a preliminary matter, it is far from clear that fear of bias derives from governments and investors as opposed to pundits and academics. Even if international arbitration does not inspire universal confidence, it seems to command greater legitimacy than any reasonable alternative. The number of countries that have recently opted out of the system, such as Bolivia and Ecuador, remains small enough to count on the fingers of one hand.[18] Albeit not without some hesitation, nations as

New York Stock Exchange. In 2008, FINRA amended the definition of a public arbitrator to add an annual revenue limitation to the definition of 'public' arbitrator, excluding from that category individuals with a direct or indirect connection to the securities industry. For example, a lawyer or accountant may not derive 10% or more of annual revenue from financial institutions, or devote 20% or more of his or her work to clients who are brokers or dealers.

[17] See, eg, M Sornarajah, 'The Retreat of Neo-Liberalisms in Investment Treaty Arbitration' in *The Future of Investment Arbitration* (C Rogers & R Alford, eds., 2009) 273.

[18] The situation seems to remain somewhat more nuanced in Venezuela, where a recent judicial decision seems to have acknowledged the validity of binding international arbitration under certain circumstances. See I D Mogolión-Rojas, 'Venezuelan Supreme Tribunal Restates ICSID Jurisdiction' (2009) 10 *Int. Arb Quarterly L. Rev.* 103 (2009), discussing an interpretative decision of 17 October 2008 given by the Venezuelan Constitutional Chamber of the Supreme Tribunal.

well as investors seem to be sticking with arbitration as a way of leveling the playing field. Even in the realm of taxation, a most public domain, arbitration has gained ground.[19]

In addition, no evidence supports the proposition that the arbitration system operates as an assembly line of decisions that favors the investor. Host states seem to win their share of cases,[20] however a win might be measured.[21] No reason exists to think that arbitrators decided

[19] Many income tax treaties now incorporate OECD proposals to integrate arbitration mechanisms into the so-called 'Mutual Agreement Procedure' which hitherto relied exclusively on negotiations among government officials with a stake in the outcome of the case. See Organization for Economic Cooperation and Development (OECD), Article 25(5) (with Sample Mutual Agreement), as of 17 July 2008. Such provisions have been incorporated in recent protocols of treaties which the United States has concluded with Belgium, Canada and Germany. See generally, Marcus Desax & Marc Veit, 'Arbitration of Tax Treaty Disputes: The OECD Proposal' (2007) 23 *Arb. Int.'l* 405; and W W Park & D R Tillinghast, *Income Tax Treaty Arbitration* (2004).

[20] For a sample of decisions favoring host states, see *Aguaytia Energy v Peru*, ICSID Case No. ARB/06/13 (2008) (involving claim for alleged violation of a stabilization agreement); *Wintershall A.G. v Argentina*, ICSID Case No. ARB/04/14 (2008) (finding of no jurisdiction by reason of inapplicability of BIT's 'most favored nation' clause to import procedural shortcut); *L.E.S.I. v Algeria*, ICSID Case No. ARB/03/8 (2005) (finding of no jurisdiction because claimant consortium possessed separate legal personality from constituent companies); *MCI Power Group v Ecuador*, ICSID Case No. ARB/03/6 (2007) (finding of no breach by Ecuador of obligations under power purchase arrangement; annulment decision is pending); *Plama Consortium Ltd. v Bulgaria*, ICSID Case No. ARB/03/24 (2008) (concluding that claimant was not entitled to protections under Energy Charter Treaty); *Continental Casualty Co. v Argentina*, ICSID Case No. ARB/03/9 (2008) (dismissing most claims for asset 'pesefication' on basis of US/Argentina BIT; upholding duty to maintain public order; and surviving claim for US$112 million reduced to US$2.8 million plus interest); and *Metalpar v Argentina*, ICSID Case No. ARB/03/5 (2008)(turning on failure to establish breach of BIT protections). The United States, as host country, prevailed against Canadian investors in the high-profile *Mondev*, *Loewen* and *Methanex* cases. In comparing interests of industrialized and non-industrialized countries, a fair-minded observer would also note awards in favor of investors from developing countries, as in *Desert Lines v Yemen*, ICSID Case No. ARB/05/17 (2008), where 'moral damages' were awarded when an Omani company charged with building roads was expelled from worksites at gun point by government-sponsored gangs. See also, *TSA v Argentina*, ICSID Case No. ARB/05/5 (2008), where a split tribunal rejected a claim brought under the Netherlands-Argentina BIT after determining that claimant's ultimate owner was an Argentine citizen; *Empresa Eléctrica del Ecuador, Inc. (EMELEC) v Republic of Ecuador*, ICSID Case No. ARB/05/9 (June 2009) (dismissing $1.7 billion claim for lack of jurisdiction); *Glamis Gold Ltd. v United States* (NAFTA claim under UNCITRAL Rules and administered by ICSID, June 2009) (dismissing Canadian mining company's claim arising from proposal to mine in California, and finding federal and state regulations did not violate NAFTA); and *Fraport AG Frankfurt Airport Services Worldwide v Republic of Philippines*, ICSID Case No. ARB/03/25 (Jurisdictional Decision July 2007) (dismissing German company's claim on jurisdictional grounds).

21 Winning and losing implicate the amount of awards as well as findings of liability. If a $100 million claim results in a $1 million award, the claimant may not really feel that it prevailed. In this connection, see Susan Franck's study of more than 100 investment awards, finding that investors brought claims treaty claims for $343 million on the average, but collected only $10 million on the average. S Franck, 'Empirically Evaluating Claims about Investment Treaty Arbitration' (2007) 86 *North Carolina L. Rev.* 1 ,49-50, 64; S Franck, *Cont.*

these matters other than according to their particular substantive or jurisdictional merits. The cases show no propensity of arbitrators to rubber stamp investors' claims. Host states can be expected to win when the claimant's legal position is weak, and to lose when the evidence and law run the other way. Arbitrators are in fact capable of getting it right on the facts and the law.

It bears noting that a rational investor would normally be expected to prefer national courts, given that arbitration implicates transaction costs in convening and funding a private tribunal whose decisions must be enforced through a complex network of treaties transcending multiple jurisdictions. These transaction costs seem to be outweighed by apprehension with respect to domestic courts of the country that allegedly has been discriminating against foreigners or expropriating their assets.[22]

To some extent, both investment and commercial arbitration have become victims of their own success. Their general acceptance often makes them objects of criticism by observers who forget what led to arbitration in the first place: a genuine concern about politicized justice in national courts. Even if accepted for want of anything better, as a 'second best' solution arbitration continues to provide what some have called 'enclaves of justice' for resolution of international economic controversies,[23] serving as the best means to enhance rule of law in a global marketplace lacking any omni-national courts or sheriffs.

'Empiricism & International Law: Insights for Investment Treaty Dispute Resolution' (2008) 48 *Va. J. Int'l L.* 767; S Franck, 'An Empirical Analysis of Investment Treaty Awards' (2007) 101 *AM. Soc'y Int'l L. Proc.* 214; and S Franck, 'International Investment Arbitration: Winning, Losing and Why', *Columbia FDI Perspectives*, No .7, 15 June 2009; Vale Columbia Center on Sustainable International Investment (www.vcc.columbia.edu). In at least one case the claimant established liability but not damages. See *Biwater Gauff (Tanzania) Ltd v Tanzania*, Award, ICSID Case No. ARB/05/22 (2008).

[22] In evaluating the value of arbitration, much depends on the observer's perspective. Few Americans have trouble understanding why Ugandans of Indian origin, dispossessed by Idi Amin, might not have relished the prospect of seeking redress before courts in Kampala during the 1970s. Yet these same Americans might bridle at the offense to sovereignty when a Canadian asks for arbitration to repair loss occasioned by a xenophobic state jury. See *Loewen v the United States*, ICSID Case No. ARB (AF)/98/3, Final Award 26 June 2003, 42 I.L.M. 811 (2003), involving a $500 million Mississippi verdict (later coupled with a $625 million security requirement) against a Canadian funeral company for breach of agreements related to burial insurance, where the transactions giving rise to the lawsuit were valued at 1% of the amount awarded.

[23] See J Paulsson, *Enclaves of Justice*, Transnational Dispute Management, Vol. 4, Issue No. 05 (Sept. 2007). A wholly separate debate, of course, surrounds whether investment treaties do in fact benefit developing nations. Many of the arguments in this connection have been summarized in the recent work of Professor Susan Franck, evaluating both the arguments in favor of foreign investment and the skepticism expressed by scholars such as Professors Susan Rose-Ackerman and Jennifer Tobin. S Franck, 'Foreign Direct Investment, Investment Treaty Arbitration & the Rule of Law' (2007) 19 *Pacific McGeorge Cont.*

While no one should belittle the need for vigilance with respect to bias in arbitration, a dialogue on the topic must be placed in context. Nations that are unhappy can revise existing models, as witnessed by the new paradigm that shows increased understanding of host states' positions, such as government veto of arbitration in tax matters[24] and limits on arbitration claims based on general welfare legislation.[25]

Moreover, host states can also walk away from the process entirely, as some have recently done. Bolivia denounced its adhesion to the ICSID Convention,[26] and Ecuador's new constitution generally prohibits treaties or other international instruments that require arbitration in commercial disputes with private parties.[27] Most host states, however, have remained with the investor-state arbitration system.

Critiques of arbitration tend toward a cyclical character, given that fashion invades the realm of ideas no less than the length for hemlines on ladies' dresses or the angle at which students tilt their caps. The recent actions of Bolivia and Ecuador echo the ideology of the 'New International Economic Order' of three decades earlier, which in turn took its cue from the 'Calvo Doctrine' of the late 19th century.[28] The

Global Business & Development Law J. 337. See generally *The Effect of Treaties on Foreign Direct Investment* (K Sauvant & L Sachs, eds. 2009).

[24] See W W Park, 'Arbitration & the Fisc: NAFTA's Tax Veto' (2001) 2 *Chicago J. Int'l Law* 231; and W W Park, 'Arbitrability & Tax' in *Arbitrability: International & Comparative Perspectives* (L Mistelis & S Brekoulakis, eds., 2008) 179, adapted from 'Tax, Arbitration & Investment Treaties' in *The Future of Investment Arbitration* (C Rogers & R Alford, eds., Oxford, 2009).

[25] The new United States model for treaty-based investment arbitration clarifies the contours of substantive investor protection with respect to 'indirect' expropriation through regulatory actions that decrease the value of an investor's property, providing that governmental regulations will not normally constitute expropriation if non-discriminatory and designed to protect legitimate welfare objectives. American implementation of the new patterns began with its free trade agreements with Singapore, Chile and Uruguay, as well as the Central American Free Trade Agreement. On the 2004 State Department model bilateral investment treaty, see eg, D Gantz, 'The Evolution of FTA Investment Provisions' (2004) 19 *Am. U. Int'l Law Rev.* 679; B Legum, 'Lessons Learned from the NAFTA: The New Generation of U.S. Investment Treaty Arbitration Provisions' (Fall 2004) 19:2 *ICSID Review-Foreign Investment Law J.* 344; and M Kantor, 'The New Draft Model U.S. BIT: Noteworthy Developments' (Aug. 2004) 21 *J. Int'l Arb.* 383.

[26] See generally, 'Bolivia Denounces ICSID Convention', Note by Marco Tutelio Montañes, 46 I.L.M. 969 (Sept. 2007); and E Gaillard, 'The Denunciation of the ICSID Convention', (26 June 2007) 237:122 *New York Law Journal* 3.

[27] See JM Marchán, 'The Treatment of Arbitration in the New Constitution of Ecuador', 22/23 *News from Institute for Transnational Arbitration* 1 (Autumn 2008/Winter 2009), discussing Article 422 of the Ecuadorian Constitution approved by referendum on 28 September 2008. In May 2009, President Correa of Ecuador announced again that his government is considering withdrawing from the ICSID system.

[28] The esteemed Argentine jurist Carlos Calvo argued that foreign investors in Latin America should submit expropriation disputes to local courts. Announced in 1868, the doctrine received fuller expression in his treatise on public international law, *Le Droit international théorique et pratique* (5th ed, 1896), Vol. I §§ 185–205, at 322–51, and Vol. III §§

Cont.

doctrines of both attempted unsuccessfully to limit investor-state arbitration, which at the time was a creature of contractual investment concessions.[29]

The 1974 Charter of Economic Rights and Duties of States provided that 'any controversy [about expropriation of foreign property] shall be settled under the domestic law of the nationalizing State and by its tribunals'.[30] This approach was ultimately rejected in arbitration awards[31] as well as by developing countries themselves when they came to see that the absence of an option for arbitration risked putting a chill on welfare-enhancing economic cooperation. The fact that such discredited ideologies again become trendy in certain academic and political circles does not mean they have merit.[32]

Central to sound analysis is the fact that investor-state arbitration is a dynamic process based on informed negotiation. Unlike American credit card companies that impose arbitration clauses through fine print in a monthly statement, investment and free trade agreements are concluded under the glare of public scrutiny by governments that represent both capital-exporting and capital-importing concerns.

III. The Mechanics of Challenge

A. Basic Texts

Challenges to arbitrators in investor-state disputes would normally be brought under either the ICSID Convention or the UNCITRAL

1280–96, at 142–55, stating that foreign nations should not intervene in South America to protect private property and debts. The corollary was that claims for improper takings of property were to be brought by the foreign investors, and were subject to the exclusive jurisdiction of host state law and courts. See also, K Lipstein, 'The Place of the Calvo Clause in International Law' (1945) 22 *Br. Yearbook of International Law* 130; and W W Park, 'Legal Issues in the Third World's Economic Development' (1981), 61 *B.U. L. Rev*. 1321.

[29] See generally, Declaration on the Establishment of a New International Economic Order, G.A. Res. 3201 & 3202, 6 Special Sess. U.N. GAOR, Supp. (No. 1) 3, 5, U.N. Doc. A/9559 (1974); G.A. Res. 3281, 29 U.N. GAOR, Supp (No. 31) 50, U.N. Doc. A/9631 (1974).

[30] Article 2(2)(c) of Charter of Economic Rights and Duties of States; G.A. Res. 3281, 29 U.N. GAOR, Supp (No. 31) 50, U.N. Doc. A/9631 (1974). The Charter was adopted by a vote of 120 to 6, with 10 abstentions. The six negative votes were cast by Belgium, Denmark, the Federal Republic of Germany, Luxembourg, the United Kingdom, and the United States. Those abstaining were Austria, Canada, France, Ireland, Israel, Italy, Japan, the Netherlands, Norway, and Spain.

[31] See Award on the Merits in Dispute Between Texaco Overseas Petroleum Company/ California Asiatic Oil Company and the Government of the Libyan Arab Republic, 17 I.L.M. 1 (1978).

[32] See generally, G Aguilar Alvarez & W W Park, 'The New Face of Investment Arbitration' *(2003)* 28 *Yale J. Int'l L.* 365.

Arbitration Rules (UNCITRAL Rules),[33] each of which provide the framework for private claims under investment treaties and free trade agreements.[34] Although these systems share some common elements, their treatment of challenges will diverge with respect to two key elements: the person who decides whether the challenge is justified, and the possibility of judicial review. On both matters UNCITRAL arbitration falls toward the commercial arbitration model.[35]

In ICSID arbitration, the touchstone will be the words in Article 14 of the ICSID Convention, which speak of the individual's ability to 'exercise independent judgment'.[36] This requirement is supplemented by a certification of independence made by the arbitrator at the beginning of the proceedings.[37] A party to the arbitration may propose disqualification

[33] Under some investment treaties, investors and host states may have the option to choose other arbitration regimes. In addition, arbitration might arise under the terms of a concession agreement containing its own arbitration clause. In some instances, arbitration claims have been filed on the same set of facts under both the ICSID Rules of Procedure for Arbitration Proceedings (ICSID Arbitration Rules) and ICC Rules. See *SPP v Egypt*. The ICC award was subject to extensive discussion in the French judicial actions that led to its vacatur. See Cour d'appel de Paris, 12 July 1984 and Cour de Cassation, 6 January 1987, translated with introductory note by Emmanuel Gaillard, in 23 I.L.M. 1048 (1984) and 26 I.L.M. 1004 (1987). For the ICSID award of 20 May 1992, see 3 ICSID Reports 241; see also W Laurence Craig, 'The Final Chapter in the Pyramids Case: Discounting an ICSID Award for Annulment Risk' (1993) 8 *ICSID Review/Foreign Investment Law Journal* 264 (1993).

[34] In theory at least, challenges might also arise under other institutional or *ad hoc* rules. For example, Article 24 (3) of the 2004 United States Model BIT provides that a claimant may submit a request for arbitration under the rules of ICSID, the ICSID Additional Facility, UNCITRAL or 'if the claimant and respondent agree, to any other arbitration institution or under any other arbitration rules'. The same language appears in Free Trade Agreements, for example Article 11.16 of the South Korea-United States FTA (pending ratification as of the moment this article goes to print). By contrast, Article 1120 of NAFTA limits itself to the ICSID, the ICSID Additional Facility, and UNCITRAL.

[35] The 1976 UNCITRAL Arbitration Rules are not to be confused with the 1985 UNCITRAL Model Law on International Commercial Arbitration (UNCITRAL Model Law, amended in 2006). While the former entails procedural rules for handling an arbitration arising from a governing instrument that warrants application of the UNCITRAL Rules, the latter constitutes a matrix of what UNCITRAL deems to be a 'model' national arbitration statute. Both the UNCITRAL Rules and Model Law address arbitrator challenge, and unsurprisingly, display vast similarities.

[36] The full text of Convention Article 14(1) contains both ethical and professional components. The full text reads: 'Persons designated to serve on the Panels shall be persons of high moral character and recognized competence in the fields of law, commerce, industry or finance, who may be relied upon to exercise independent judgment. Competence in the field of law shall be of particular importance in the case of persons on the Panel of Arbitrators'. See generally, A Sheppard, 'Arbitrator Independence in ICSID Arbitration' in C Binder, U Kriebaum, A Reinisch & S Wittich (eds), *International Investment law for the 21st Century: Essays in Honour of Christoph Schreuer* (OUP, 2009) 131, at 147-48. Reforms proposed by Mr Sheppard include, *inter alia*, (i) a change in the grounds for challenge from 'manifest' lack independence to 'justifiable doubts' as to independence and impartiality', and (ii) decisions on challenge are to be made by an independent *ad hoc* committee rather than the challenged arbitrator's colleagues on the tribunal.

[37] Rule 6(2) of the ICSID Arbitration Rules requires each arbitrator, prior or during the Tribunal's first session, to sign a declaration affirming, *inter alia*, that the individual will

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of an arbitrator on account of any fact indicating a 'manifest' inability to meet that standard.[38]

When a dissatisfied litigant contests an arbitrator's fitness in an ICSID proceeding, the remaining arbitrators normally determine whether the individual lacks the capacity to exercise independent judgment.[39] Any review of the resulting award would be made by an ICSID-appointed panel on limited treaty-based grounds,[40] rather than national judges who might conduct their own review of independence and impartiality. By contrast, outside ICSID, challenges to arbitrators in commercial arbitrations would initially be heard by the relevant supervisory institution and then again come before whatever national court is charged with considering motions to review awards.

Challenge under the UNCITRAL Rules differs in procedural mechanics, notwithstanding a basic similarity in the standards themselves. Article 10 provides for challenge if circumstances give rise to 'justifiable doubts' about the arbitrator's impartiality or independence.[41] Unless the other side agrees or the arbitrator withdraws voluntarily, the challenge

'judge fairly as between the parties, according to the applicable law' and attach a statement of past and present professional, business, and other relationships with the parties as well as any other circumstance that might cause the arbitrator's reliability for independent judgment to be questioned by a party. In signing the declaration, the arbitrator assumes a continuing obligation promptly to notify ICSID of any such relationship that subsequently arises during the proceedings.

[38] ICSID Convention Article 57, provides as follows: 'A party may propose to a Commission or Tribunal the disqualification of any of its members on account of any fact indicating a manifest lack of the qualities required by paragraph (1) of Article 14. A party to arbitration proceedings may, in addition, propose the disqualification of an arbitrator on the ground that he was ineligible for appointment to the Tribunal under Section 2 of Chapter IV'.

[39] See ICSID Convention Article 58. The challenged arbitrator would first be given the opportunity to 'furnish explanations'. If the challenge relates to a majority of the arbitral tribunal, or if the remaining two members are equally divided, the disqualification decision will be made by the Chairman of the ICSID Administrative Council, a post filled *ex officio* by the President of the World Bank pursuant to Article 5 of the ICSID Convention. See generally, C Schreuer, *The ICSID Convention* (2001) at 1202-1206; see also, the procedure amplified in Rule 9 of the Arbitration Rules adopted by the ICSID Administrative Council pursuant to Article 6 of the Convention itself.

[40] ICSID Convention Article 52. The limited grounds for challenge do not include an arbitrator's lack of independent thinking. An award may be set aside for the following reasons: (1) improper constitution of the tribunal; (2) tribunal excess of authority; (3) corruption of a tribunal member; (4) serious departure from a fundamental rule of procedure; or (5) failure of the award to state reasons. This challenge is made not to national courts, but pursuant to an internal ICSID process triggered by a letter to the ICSID Secretary General. Review is conducted by an *ad hoc* Committee of three persons with authority to annul the award in part or in total. If an award is annulled, either party may require that it be submitted to a new tribunal.

[41] UNCITRAL Rules Article 10(1). A similar formulation exists in Article 12 of the UNCITRAL Model Law.

decision will be made by the appropriate 'appointing authority' that constituted (or would otherwise have constituted) the tribunal itself.[42]

In UNCITRAL arbitration, as in ordinary commercial cases, the ultimate validity of any appointing authority decision will be subject to review by national courts under the appropriate arbitration statute and/or within the framework of either the New York Convention.[43]

In some cases an arbitrator's challenge will take place under what might be seen as a hybrid process applying the ICSID Additional Facility Rules. In such instances, the arbitration will be supervised by ICSID, under procedures similar to those of regular ICSID cases, but *outside* the framework of the Washington Convention. The rule for challenge remains the ability to 'exercise independent judgment',[44] and the decision will normally be made by the challenged arbitrator's remaining colleagues.[45] However, national courts might also have their say on the matter when asked to vacate an award pursuant to their own standards of arbitrator fitness.[46]

[42] The wording in Article 12 contains an unfortunate (albeit perhaps unavoidable) complexity with respect to who gets to decide arbitrator challenges, distinguishing between situations (i) when the initial appointment was made by an appointing authority (situations where *kompetenz* to hear the challenge lies with the same appointing authority), (ii) when the initial appointment was not made by an appointing authority (in which case the challenge will be heard by a previously designated authority), and (iii) all other cases, whereby 'the decision on challenge will be made . . . by the appointing authority provided in article 6' of the Rules, under which the Permanent Court of Arbitration serves by default as the entity to designate an appointing authority if the parties cannot agree.

[43] Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958. In some instances, the relevant treaty framework would be found in the Inter-American Convention on International Commercial Arbitration, commonly known as the 1975 Panama Convention. See 9 U.S.C. Chapter III. While similar in their basic structure, the two Conventions differ in significant respects. For example, the Panama Convention does not require judges to refer parties to arbitration, or set forth conditions that must be satisfied by the party seeking award enforcement. Moreover, only the Panama Convention contains reference to arbitration rules (those of the Inter-American Commercial Arbitration Commission) that apply in default of party choice. See generally AJ van den Berg, 'The New York Convention 1958 & Panama Convention 1975: Redundancy or Compatibility?' (1989) 4 *Arb. Int'l* 229; and J Bowman, 'The Panama Convention & Its Implementation under the Federal Arbitration Act' (2000) 11 *Am. Rev. Int'l Arb*. 116.

[44] ICSID Additional Facility Rules, Schedule C Arbitration Rules, Article 8 ('Qualifications of Arbitrators').

[45] Ibid, Article 15(5) ('Disqualification of Arbitrators').

[46] The ICSID Additional Facility Rules might apply in disputes where ICSID jurisdiction would not otherwise exist, because either the host state or the investor's state is not party to the Washington Convention. For example, in the *Metalclad* case an American company filed an Additional Facility Claim related to a hazardous waste disposal facility in Mexico. The arbitrators found that Mexican regulatory action denied 'fair and equitable treatment' and constituted expropriation without adequate compensation. Mexico petitioned to have the award set aside by the British Columbia Supreme Court which had jurisdiction by virtue of the arbitration's official situs fixed in Vancouver, notwithstanding that for convenience hearings had been held in Washington. The court found that some but not all

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B. Filling the Gaps

1. Institutional Rules and Case Law

Implementation of ICSID and UNCITRAL challenge standards would be a very difficult job indeed if investor-state cases were isolated from lessons learned in other varieties of arbitration. Notions such as ability 'to exercise independent judgment'[47] or 'justifiable doubts' as to impartiality or independence[48] touch on notions of proper behavior shared with other arbitral systems.

In examining a motion to disqualify an arbitrator in an investor-state case, the decisions in analogous commercial arbitrations will inevitably have some influence. Consideration will be given to how things have been done pursuant to institutional rules, national statutes, other multilateral treaties (such as the New York Convention) and the so-called 'soft-law' of professional guidelines. These different arbitration standards often follow roughly similar paths, albeit with different emphasis or minor variation.

For example, the ICC Rules of Arbitration (ICC Rules) speak of arbitrator independence, but not impartiality.[49] By contrast, impartiality as well as independence has been explicitly addressed in the UNCITRAL Rules,[50] UNCITRAL Model Law,[51] the AAA/ABA Code of Ethics,[52] the IBA Guidelines,[53] and the LCIA Arbitration Rules.[54] Under the UNCITRAL Model Law and other statutes which follow its paradigm, arbitrator bias as a ground for award vacatur seems to be subsumed under the general rubric of 'public policy' violation.[55] The IBA Guidelines mention 'actual bias' as a ground for declining appointment.[56]

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of the arbitrators' conclusions exceeded their jurisdiction. See *Metalclad v United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award of 30 August 2000, reprinted in 16 *Int'l Arb. Rep*. 62 (January 2001).

[47] ICSID Convention art. 14(1) (Int'l Ctr. for Settlement of Inv. Disputes 2006); and, ICSID Additional Facility Rules, Schedule C Arbitration Rules, Article 8.

[48] UNCITRAL Rules art. $_{10(1)}$. See also, UNCITRAL Model Law art. 12(2), which reads: 'An arbitrator may be challenged only if circumstances exist that give rise to justifiable doubts as to his impartiality or independence, or if he does not possess qualifications agreed to by the parties'.

[49] ICC Rules, Article 9(2).

[50] UNCITRAL Rules, Article 10.

[51] UNCITRAL Model Law, Article 12.

[52] AAA/ABA Code of Ethics, Article 7(1).

[53] IBA Guidelines General Principles (1)

[54] LCIA Arbitration Rules (LCIA Rules) Articles 5.2 and 10.3.

[55] UNCITRAL Model Law, Article 34(2)(b)(ii).

[56] IBA Guidelines, Explanation to General Standard 2.

Most standards require an arbitrator's disclosure of circumstances that may cause doubts as to his or her ability to serve impartially and independently during a proceeding.[57] Some make reference to 'justifiable' doubts,[58] while others direct the arbitrator to ask whether the questionable circumstances would cause doubt 'in the eyes of the parties'.[59] The IBA Guidelines include both 'justifiable doubts' and doubts 'in the eyes of the parties' as factors for an arbitrator to consider.[60]

Some rules address arbitrator nationality. When litigants are of different nationalities, the LCIA Rules[61] and the ICSID Convention[62] generally provide that an arbitrator may not have the same nationality as either party. Conversely, the UNCITRAL Model Law provides that 'no person shall be precluded by reason of his nationality from acting as an arbitrator,' unless the parties agree otherwise.[63] The ICC Rules direct the ICC Court of Arbitration to consider an arbitrator's nationality.[64]

In arbitration outside the treaty-based investor-state context, a decision on challenge for alleged conflict will often need to be made on the basis of both arbitration rules and applicable statute. Imagine, for example, arbitration conducted in England under the rules of the LCIA. One side complains that the arbitrator has prejudged some vital question by statements made in a procedural order. The challenging party would begin by citing Article 10.3 of the LCIA Rules permitting challenge on the basis of circumstances 'that give rise to justifiable doubts as to [the arbitrator's] impartiality or independence'.[65] There might also be a citation to Article 10.2 of the LCIA Rules, which makes reference to an arbitrator who 'does not act fairly and impartially as between the parties'.[66]

If the institutional challenge before the LCIA fails,[67] the unhappy litigant might also bring a court challenge under English statute for 'justifiable

[57] See AAA/ABA Code of Ethics, Canon II(A)(2); IBA Guidelines, General Standard 2; ICC Rules, Article 7; ICSID Arbitration Rules, Rule 6(2); LCIA Rule 5.3; UNCITRAL Rules, Article 9. For discussion of a particularly problematic set of standards, see M. Scott Donahey, 'California & Arbitrator Failure to Disclose' (2007) 24:4 *J. Int'l Arb.* 389 ,
[58] See UNCITRAL Rules, Article 9; LCIA Rules Article 10.3
[59] See ICC Rules, Article 7(2).
[60] IBA Guidelines, General Standards 2 and 3; in particular, General Standard 2(c), 2(d) and Explanation to General Standard 3(a).
[61] LCIA Rules, Article 6.1.
[62] ICSID Convention Article 39.
[63] UNCITRAL Model Law, Article 11(1).
[64] ICC Rules, Article 9(1).
[65] LCIA Rules art. 10.3 (LCIA 1998).
[66] Ibid art. 10.2.
[67] Under LCIA Rules, challenges are heard by a Division of the LCIA Court itself, usually pursuant to written memorials and on occasion (albeit rarely) with oral argument. Unlike

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doubts'[68] as to the arbitrator's impartiality, or an application to annul the award itself for 'serious irregularity'[69] including failure to 'act fairly and impartially' as between the parties.[70]

2. The Specificity of Investment Cases

Suggestions that ethical rules in commercial cases inform standards of integrity in investment arbitration, whether in ICSID proceedings or otherwise, sometimes meet an objection resting on the alleged uniqueness of investor-state dispute resolution. While not devoid of interest, such contentions about the special nature of investor-state arbitration usually overstate its inimitability.[71]

A clear cross-pollination of national and professional ethical standards does exist as between commercial and investor-state cases. The latter holds no monopoly on the 'private judging' that affects societal and economic well-being.[72] Ethical principles in commercial cases fertilize decisions in investment cases and vice versa.

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many other arbitral institutions, the LCIA publishes a sanitized version of challenge decisions to guide future litigants' with respect to nomination or challenge. See GNicholas & C Partasides, 'LCIA Court Decisions on Challenges to Arbitrators: A Proposal to Publish' (2007) 23 *Arb'n Int'l* 1 (2007), Annex: Survey of Exiting LCIA Challenge Decisions, at 21 – 41.

[68] Arbitration Act, 1996, c. 23, § 24(1) (Eng.).

[69] Ibid § 68.

[70] Ibid § 33. For an illustration under the ICC Rules, see discussion of challenge in *AT&T v Saudi Cable*, Court of Appeal (Civil Division),15 May 2000, 2000 WL 571190, [2000] 2 Lloyd's Rep. 127, [2000] 2 All E.R. (Comm) 625. In light of the fact that the arbitration began in 1995, the application to set aside partial awards invoked Section 23 of the 1950 Arbitration Act (not the 1996 Act) which speaks of arbitrator 'misconduct'. Ibid at 123, 136–37.

[71] One recent essay suggested that commercial arbitration was conducted 'entirely by and for professionals'. See G Aguilar Alvarez & WM Reisman, *The Reasons Requirement in International Investment Arbitration: Critical Case Studies* (2008), at 2. If this were true, of course, professors who teach about policy aspects of business disputes should be exposed as charlatans, and large portions of their scholarly work eliminated as meaningless. Decisions like *Mitsubishi Motors Corp. v Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1984), which address safeguards involving antitrust claims, could be removed from national arbitration law, along with cases interpreting the language of New York Convention Article V(2)(b) on public policy violations. Surprisingly, the authors also suggest that international commercial awards are 'rarely published', notwithstanding the extensive collections of awards published in places such as the ICC Recueil des Sentences, Mealey's International Arbitration Reports, *Journal de droit international*, ASA Bulletin, and *Revue de l'arbitrage*.

[72] For an exploration of the arguments on both sides, see S Wilske, M Raible & L Markert, 'International Investment Treaty Arbitration and International Commercial Arbitration – Conceptual Difference or only a "Status Thing"' (2008) 1 *Contemporary Asia Arbitration Journal* 213.

Nor are the public effects of commercial arbitration any less real than those of treaty-based investor-state cases[73]. If the financial crisis of 2008 demonstrates anything, it teaches that private choices have public consequences. Contract disputes affect the world's aggregate social and economic welfare no less than treaty controversies,[74] and breaches of international law end up being decided in commercial arbitration just as in treaty-based proceedings.[75]

IV. Transnational Standards

A. Soft Law

Increasingly, conflicts of interest implicate non-governmental instruments such as the professional standards issued by the IBA or the AAA. To some extent such guidelines will be supplemented by the writings of scholars and practitioners setting forth what might be termed the 'lore' of international arbitral procedure.[76]

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[73] One unfortunate effect of BIT-arbitration puffery lies in its tendency to reinforce stereotypes of investor-state arbitration as so extraordinary as to be somehow illegitimate. A better course might be to acknowledge that all international arbitration is designed to enhance procedural and political neutrality by granting decision-making power to persons other than the national bodies with a stake in the outcome.

[74] For example, insurance arbitrators play a vital role in maintaining respect for the sanctity of contract, which in turn permits manufacturers to meet otherwise disruptive risks. Gas price revision arbitration affects how much people pay for heat in the winter. And arbitration of pharmaceutical license disputes can have an impact on the price of drugs.

[75] See eg, the LIAMCO arbitration with respect to the Libyan expropriation of American assets, discussed in *LIAMCO v Libya*, 482 F. Supp. 1175 (S.D.N.Y. 1980); *vacated* 6 May 1981, D.C. Cir., No. 80-1207. See also Award on the Merits in Dispute Between Texaco Overseas Petroleum Company/California Asiatic Oil Company and the Government of the Libyan Arab Republic, 17 I.L.M. 1 (1978).

[76] See, eg, L Reed & J Sutcliffe, 'The "Americanization" of International Arbitration' (2001) 16 *Int'l Arb. Rep*. 37 (2001); J Lew & L Shore, 'Harmonizing Cultural Differences in International Commercial Arbitration' (August 1999) 54 *Dispute Resolution J.* 32; K-H Böckstiegel, 'Major Criteria for International Arbitrators in Shaping an Efficient Procedure' in *Arbitration in the Next Decade* (ICC Int'l Ct. Bull. Supp. 1999); JJ Coe, 'Pre-Hearing Techniques to Promote Speed and Cost-Effectiveness - Some Thoughts Concerning Arbitral Process Design' (2002) 17 *Int'l Arb. Rep.* 22; P Friedland, 'Combining Civil Law and Common Law Elements in the Presentation of Evidence in International Commercial Arbitration - Novel or Tested Standards?' (2000) 17 *J. Int'l Arb*. 3; H M Holzmann, 'Balancing the Need for Certainty and Flexibility in International Arbitration Procedure' in R Lillich & C Brower (eds), *International Arbitration in the 21st Century* (1993); M Huleatt-James & R Hunter, 'The Laws and Rules Applicable to Evidence in International Arbitration Procedure' in R Lillich & C Brower (eds), *International Arbitration in the 21st Century* (1993); M Hunter, 'Modern Trends in the Presentation of Evidence in International Commercial Arbitration' (1992) 3 *Amer. Rev.* 204; A F Lowenfeld, 'The Two-Way Mirror: International Arbitration as Comparative Procedure' (1995) *Mich. Y.B. Int'l Studies* 163; J J Myers, 'Ten Techniques for Managing Arbitration Hearings' (Jan.-Mar. 1996) 51 *Disp. Resol. J.* 28; and J Uff, 'The Bill Tompkins Memorial Lecture' 1994 (1995) 61 *Arbitration* 18.

The use of the term 'soft law' to designate such guidelines has led to unfortunate misinterpretation and misapprehension. Some observers express concern that non-governmental instruments will undermine the reasonable measure of certainty sought by merchants and investors to guide decision-making. The right critique has been aimed at the wrong target.[77]

When properly applied, such standards can enhance certainty by providing an alternative to *ad hoc* rulemaking by jurists whose facile eloquence may articulate 'general legal principles' that constitute little more than a fig leaf covering personal preferences.[78] If crafted with intelligence, professional guidelines present a better guess about the parties' shared *ex ante* expectations than the unbridled discretion of overly clever arbitrators who pursue their own agendas.[79]

Soft law instruments thus represent one check on the imperial decision-maker, and perhaps the only standard that can permit elaboration of procedural law through what John Rawls called the 'veil of ignorance' about the contingencies of a rule's application.[80] Arbitrators who interpret preexisting norms have less leeway to pick rules that will lead to the outcome favoured by their subjective predispositions.[81]

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[77] See WM Reisman, 'Soft Law Instruments Should Have No Place in International Arbitration' *ITA 'Soft Law Symposium* Washington, 9 April 2008.

[78] W W Park, 'National Law and Commercial Justice' (1989) 63 *Tulane L. Rev*. 647 ; W W Park, 'Neutrality, Predictability and Economic Cooperation' (1995) 12:4 *J. Int'l Arb*. 99; and W W Park, 'Why Courts Review Arbitral Awards' in R Briner, LY Fortier, K-P Berger & J Bredow (eds), *Recht der Internationalen Wirtschaft und Streiterledigung im 21. Jahrhundert: Liber Amicorum Karl-Heinz Böckstiegel* (2001) 595.

[79] W W Park, 'Arbitration's Protean Nature: The Value of Rules and the Risks of Discretion' (The 2002 Freshfields Lecture), 19 *Arb. Int'l* 279 (2003); W W Park, 'The Procedural Soft Law of International Arbitration' in L Mistelis & J Lew (eds), *Pervasive Problems in International Arbitration* (2006) 141; W W Park, 'Private Disputes and the Public Good' (2005) 20 *Am. U. Int'l L. Rev*. 903; and W W Park, 'Procedural Default Rules Revisited' in J Lew & L Mistels (eds), *Arbitration Insights* 331 (2006).

[80] See J Rawls, *A Theory of Justice* (1971), § 24, at 136. Rawls affirmed, inter alia, that to be just, rules should be uninformed by any existing litigation strategy, not created in function of what some might call the 'ouch test' which looks to see who gets hurt by a particular rule. On some matters the 'veil of ignorance' already finds limited recognition in arbitration. For example, although different methods exist to calculate arbitrators' fees (ICC looks to the amount in dispute, while AAA and LCIA base fees on time spent), no institution gives an arbitrator discretion to opt for one approach or the other (*ad valorem* or hourly) after seeing how the case develops.

[81] Similar principles obtain with respect to the substantive law applied to the merits of the dispute, where most business managers seek predictability in normal commercial relations. As the late Dr Francis Mann noted, 'no merchant of any experience would ever be prepared to submit to the unforeseeable consequences which arise from application of undefined and undefinable standards described as rules of a lex of unknown origin'. F.A. Mann, *Introduction Lex Mercatoria and Arbitration* (Thomas Carbonneau ed., 1990) xxi.

Ethical soft law forms part of a more general phenomenon by which standards elaborated by professional associations serve to guide arbitral decision-making in matters related to evidence[82] and case management.[83] Built on arbitral lore memorialized in articles, treatises, and learned papers, these guidelines represent what might be called the 'soft law' of arbitral procedure, in distinction to the firmer norms imposed by statutes and treaties.[84] Nothing prevents parties from agreeing to override the guidelines, which enter the arbitration only when such agreement proves impossible.

B. Professional Guidelines

Among the many professional guidelines on arbitrator comportment, two of the most influential include the IBA Guidelines[85] and the Code of Ethics issued jointly by the AAA and the ABA.[86] Whatever one's views about the wisdom of particular rules, most informed observers recognize the rules' far-reaching effects, the latter principally for domestic arbitration conducted within the United States and the former with respect to most international commercial arbitral proceedings. For want of anything better, they get pressed into service to fill the gaps left by overly vague institutional rules or lack of foresight by the parties' advisers.

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[82] See IBA Working Party, Commentary on the New IBA Rules of Evidence in International Commercial Arbitration (2000) 2 *Bus. Law Int'l.* 14; see also, M Bühler & C Dorgan, 'Witness Testimony Pursuant to the IBA Rules of Evidence in International Commercial Arbitration' (2000) 17 *J. Int'l Arb*. 3 (No. 1). The rules are available at www.ibanet.org.

[83] The American College of Commercial Arbitrators published a compendium of 'Best Practices' for business arbitration. See College of Commercial Arbitrators, *Guide to Best Practices in Commercial Arbitration* (October 2005); see also, UNCITRAL Notes on Organizing Arbitral Hearings (1996); and ICC Commission, Techniques for Controlling Time and Cost in Arbitration, ICC Publication No. 843 (2007).

[84] For a recent survey of these non-governmental initiatives, see W W Park, 'Three Studies in Change', in *Arbitration of International Business Disputes* (Oxford University Press, 2006) 45-65.

[85] IBA Guidelines, approved by the IBA Council on 22 May 2004, published in 9 (No. 2) *Arbitration & ADR* (IBA) 7 (October 2004); See M Ball, 'Probity Deconstructed – How Helpful, Really are the New IBA Guidelines on Conflicts of Interest in International Arbitration' (Nov. 2004) 15 *World Arb. & Mediation Rep* 333 ; and J Paulsson, 'Ethics and Codes of Conduct for a Multi-Disciplinary Institute' (2004) 70 *Arbitration* 193, 198-99.

[86] The 2004 AAA/ABA Code of Ethics represents a modification of an earlier Code adopted in 1977. See generally, B H Sheppard, Jr., 'A New Era of Arbitrator Ethics for the United States' (2005) 21:1 *Arb. Int'l* 91; and PD Friedland & JM Townsend, 'Commentary on Changes to the Commercial Arbitration Rules of the American Arbitration Association' (Nov. 2003-Jan. 2004) 58 *Dispute Resolution J*. 8.

1. The International Bar Association

Perhaps the most oft-cited of these standards can be found in the IBA Guidelines.[87] Rightly or wrongly, this list has entered the canon of sacred documents cited when an arbitrator's independence is contested. The general standards are both objective and subjective. According to the IBA Guidelines, arbitrators should decline appointment if they have doubts about their ability to be impartial or independent[88] or if justifiable doubts exist from a reasonable third person's perspective.[89]

In practice, the dominant test as elaborated in judicial and institutional decisions will be an objective one. Inevitably, challenges by parties will focus on arbitrators who have already discounted any self doubts they might have. Arbitrators who consider themselves incapable of performing their duties with integrity will normally decline appointment or resign. It would be odd to hear an arbitrator say, 'Please note that I'm probably biased. But let me know if you think otherwise'.

By contrast, the IBA Guidelines set forth a more subjective standard for disclosure, requiring communication of facts or circumstances that may 'in the eyes of the parties' give rise to doubts about impartiality or independence.[90]

A disclosure does not necessarily mean disqualification. Evaluation of the potential conflict must be made by the parties as well as whatever body will hear the challenge.[91] In such instances, the relevant test will almost inevitably be something along the lines of justifiable doubts in the mind of a reasonable person.

Excessive disclosure can cause as many problems as inadequate disclosure. If an overscrupulous conscience announces links that would

[87] The IBA Guidelines on Conflicts of Interest in International Arbitration should not be confused with the less controversial IBA Rules of Ethics for International Arbitrators (1987). The latter include broad (and somewhat bland) admonitions about being competent, diligent, efficient, and remaining 'free from bias.' See IBA Rules of Ethics for International Arbitrators, Rules 1 and 2.

[88] IBA Guidelines, Standard 2(a).

[89] IBA Guidelines, Standard 2(b).

[90] IBA Guidelines, Standard 3(1).

[91] In cases of supervised arbitration under the rules of the AAA, ICC, or LCIA, an institutional challenge will usually be brought prior to any court action. See eg, *AT&T v Saudi Cable*, Court of Appeal (Civil Division), 15 May 2000, 2000 WL 571190, [2000] 2 Lloyd's Rep. 127, [2000] 2 All E.R. (Comm) 625. Following a mix-up with various versions of the chairman's curriculum vitae, a challenge was brought for failure to report a position on the board of directors of a company that was in direct competition with the losing party in the arbitration. Ibid at 130. An unsuccessful challenge before the ICC Court preceded an equally unfruitful attempt to have the award vacated in a judicial action at the arbitral seat in London. Ibid at 138.

not normally raise questions, this might cause parties to wonder whether there is more going on than meets the eye.

One of the most useful (albeit controversial) features of the IBA Guidelines lies in its enumeration of illustrative elements that create varied levels of arbitrator disclosure.[92] A 'Red List' describes situations that give rise to justifiable doubts about an arbitrator's impartiality. Some are non-waivable (such as a financial interest in the outcome of the case), while others (such as a relationship with counsel) may be ignored by mutual consent. An 'Orange List' covers scenarios (such as past service as counsel for a party) which the parties are deemed to have accepted if no objection is made after timely disclosure. Finally, a 'Green List' enumerates cases (such as membership in the same professional organization) that require no disclosure.

2. American Rules

One frequently hears complaints about the 'Americanization' of arbitration,[93] connoting aggressive litigation tactics that include hefty boxes of unmanageable exhibits, costly pretrial discovery, and disruptive objections to evidence.[94] One also notes the internationalization of American dispute resolution practices, as reflected in greater use of written testimony and reasoned awards.[95]

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[92] See IBA Guidelines pt. II article 4 *et seq.* (Council of the Int'l Bar Ass'n 2004.

[93] See eg, R Alford, 'The American Influence on International Arbitration' (2003) 19 *Ohio State J. Disp. Resol.* 69. This article forms part of a symposium issue, *The Americanization of International Dispute Resolution*, that includes contributions by Susan Karamanian, Elena Helmer, and Cesare Romano. The wider influence of American law has also been noted by B Audit, in 'L'Américanisation du droit' (2001) 45 *Arch. philosophie du droit* 7.

[94] Not all American practices evoke disapproval, however. In a provocative article subtitled 'Why Civil Law Arbitrators Apply Common Law Procedures', an eminent Zürich attorney studied the way some Continental lawyers can be reborn to an appreciation of Anglo-American litigation techniques such as cross examination and document production. See M Wirth, 'Ihr Zeuge, Herr Rechtsanwalt! Weshalb Civil-Law-Schiedsrichter Common-Law-Verfahrensrecht anwenden', 1 *Schieds VZ* (Zeitschrift für Schiedsverfahren/ German Arbitration Journal) (Jan.–Feb. 2003).

[95] See PD Friedland & A Santens, 'The Internationalization of American Arbitration', 18(2) News & Notes, Inst. Transnat'l Arb. 1 (Spring 2004). See generally, B H Sheppard, 'A New Era of Arbitrator Ethics in the United States' (2005) 21 *Arb. Int'l* 91; B H Sheppard, 'A New Era of Arbitration Ethics: The 2004 Revision to the AAA/ABA Code of Ethics for Arbitrators in Commercial Disputes' 18:2 News & Notes, Inst. Transnat'l Arb. 1 (Spring 2004); PD Friedland & J M Townsend, 'Commentary on Changes to the Commercial Arbitration Rules of the American Arbitration Association' (Nov. 2003–Jan. 2004) 58 *Disp. Res. J.* 8; B Meyerson & J M Townsend, 'Revised Code of Ethics for Commercial Arbitrators Explained' (Feb.–Apr. 2004)59 *Disp. Res. J.* 10; and D Branson, 'American Party-Appointed Partisan Arbitrators – Not The Three Monkeys' (2004) 30 *U. Dayton Law Rev.* 1.

Perhaps the most striking example of internationalization finds itself in the evolution of arbitral ethics. Traditionally, American practice presumed party-nominated arbitrators to be partisan, and thus permitted *ex parte* communication with their appointers.[96] Arbitrators nominated by one side were expected to be non-neutral unless explicitly agreed otherwise.[97]

Most arbitration conducted within the United States was brought into line with global standards requiring independence for all arbitrators. Under the 2004 joint AAA/ABA Code of Ethics, a party-nominated arbitrator may be non-neutral only if so provided by the parties' agreement, the arbitration rules, or applicable law.[98] The new attitude expressed in the AAA/ABA Code of Ethics was reinforced by changes in the AAA's domestic commercial arbitration rules, effective July 2003, establishing a presumption of neutrality for all arbitrators.[99] These rules coexist along with idiosyncrasies of practice among particular institutions and states.[100]

Readers must be careful not to confuse the AAA/ABA Code of Ethics with other American guidelines,[101] including recently abandoned

[96] During the proceedings, arbitrators should not engage in *ex parte* communications about the case with counsel. Nevertheless, some institutional rules remain silent on the matter. Notably, the ICC has shown itself reticent to publish an explicit prohibition. See generally, Y Derains & E A Schwartz, *A Guide to the ICC Rules of Arbitration* (2d. Ed. 2005), at 131-32; see also W Laurence Craig, W W Park & J Paulsson, *International Chamber of Commerce Arbitration* (3d Ed. 2000), Section 13.07, at 242, which seems to acknowledge that a practice of *ex parte* communication might be agreed by the parties.

[97] See Canon VII, of the 1977 version of the AAA/ABA Code of Ethics for Arbitrators in Commercial Disputes. For a critique of the practice, see S Lieberman, 'Something's Rotten in the State of Party-Appointed Arbitration: Healing ADR's Black Eye That Is Non-neutral Neutrals' (2004) 5 *Cardozo J. Conflict Res*. 215.

[98] See Preamble ('Note on Neutrality') and Canon X, of the 2004 version of the AAA/ABA Code of Ethics. See generally 'Report to ABA House of Delegates' (Winter 2003–2004) 4:1 *Int'l Arb. News*.

[99] American Arbitration Association Commercial Arbitration Rules & Mediation Procedures, Rule 18 (applicable unless there has been agreement otherwise) prohibits parties from communicating *ex parte* with an arbitrator, except that parties may communicate with party-nominated (rather than presiding) arbitrators (i) to describe the nature of the controversy or (ii) to discuss selection of a presiding arbitrator. Under Rule 12(b), party-nominated arbitrators must meet general standards of impartiality and independence unless there has been agreement otherwise, as permitted by Rule 17(a)(iii).

[100] See eg, *Crédit Suisse First Boston Corp. v Grunwald*, 400 F. 3d 1119 (9th Cir. 2005), involving the controversial California Ethical Standards for Neutral Arbitrators. In the case at bar, arising under the rules of the National Association of Securities Dealers, the California standards were found to be preempted by the 1934 Securities Exchange Act. *Id.* at 1121.

[101] The College of Commercial Arbitrators has published useful commentary on the topic. See J H Carter, R V Glick, J Lehrman & B E Meyerson, 'Appointment, Disclosures and Disqualification of Neutral Arbitrators' in C E von Kann (editor in Chief), J M Gaitis & J R Lehrman (eds), *College of Commercial Arbitrators Guide to Best Practices in Commercial Arbitration* Chapter 2, at 7-26 (2006). Other thoughtful observations can be found in *The Leading Arbitrators' Guide to International Arbitration* (L Newman & R Hill, eds., 2008), *Cont.*

proposals from within the ABA for a 'Disclosure Checklist.'[102] The risk in such guidelines, of course, is that an unhappy loser in an arbitration might take inspiration from the checklist as a roadmap for annulment motions. Like the mnemonic devices used by some administrative staff at arbitral institutions, checklists and 'rules of thumb' should be seen as starting points for analysis rather than black letter destinations.[103]

C. Synthesizing Legal Norms

Decisions of national courts, arbitral institutions, and arbitrators (in the case of ICSID proceedings) all contribute to the elaboration of what might be called a jurisprudence of ethical standards. Those who must rule on disqualification motions will inevitably seek some understanding of what others have done in analogous cases. Although the decisions do not constitute binding precedent in the sense of many national legal systems, they do provide an indication of what others consider the right approach, and as such contribute to transnational ethical norms.

Admittedly, the practice of looking to different sources of authority will not be satisfying to those who seek a hierarchy of clear authority within a single legal jurisdiction. For better or for worse, however, no such unified judicial system governs the world of international economic relations.[104] In the world as we find it, an approach taking

with contributions by Gerald Aksen (The Tribunal's Appointment, Chapter 2), Andreas Lowenfeld (The Party-Appointed Arbitrator, Chapter 3) and Allan Philip (The Duties of an Arbitrator, Chapter 5).

[102] Originally proposed in January 2008 by a subcommittee of the Arbitration Committee of the ABA Dispute Resolution Section, the draft 'Best Practices for Meeting Disclosure Requirements' (often called simply the 'Disclosure Checklist') encountered considerable opposition from within both the ABA Section of International Law and the College of Commercial Arbitrators. In April 2009, the Council of the Dispute Resolution Section refused to approve the draft.

[103] Mnemonic devices have occasionally been pressed into service. An acronym coined by a long-forgotten Bostonian runs through five elements for arbitrator disqualification, asking whether a financial or personal relationship can be characterized as (i) substantial, (ii) continuing, (iii) recent, (iv) obvious, and/or (v) direct. The initial letters of each word spell 'SCROD', a name found on menus at New England restaurants to describe a white fish in the cod or haddock family, served split and deboned. One might puzzle over the attribute 'obvious', given that the temptation to defect from duty remains problematic even if occasioned by an otherwise hidden relationship.

[104] The closest approximation to a supreme court for international law might be found in the International Court of Justice (ICJ), a body with power to decide cases only when states accept jurisdiction through treaty or declaration. See ICJ Statute Articles, 34, 35 and 36. In diplomatic protection before the ICJ, foreign investors remain captive to the political predisposition of their home countries. Even when a state agrees to sponsor a claim, the Court itself may find the connection between the investor and the state insufficient to justify standing. See *Barcelona Traction, Light and Power Co., Ltd. (Belgium) v Spain* (2nd Phase), 1970 I.C.J. 3, 9 I.L.M. 227 (1970) (forbidding Belgium from espousing claim of Belgian shareholders in Canadian company). For a rare case where the ICJ did hear an investment dispute, see *Elettronica Sicula S.p.A v Italy* (the '*ELSI* Case'), 1989 I.C.J. 15 and *Cont.*

into consideration relevant national and administrative practice will likely provide greater predictability and fairness than allowing each challenge decision to be fashioned from whole cloth.

Grounds for challenge often present themselves with slight but relevant factual variations. For example, conflicts decisions commonly address an arbitrator's relationship with an institution or company which, in turn, has links to one of the parties in the case.[105] The potential for taint will depend on the specific nature and intensity of the relationship, whether as director, owner, counsel or customer.[106]

In an effort to guide both arbitrators and litigants, at least one arbitral institution has published sanitized versions of its challenge decisions. A compendium of challenges under the rules of the LCIA groups the various grounds for disqualification, including the two general rubrics of impartiality or independence, as well as the British formulation of a 'duty to act fairly between the parties'.

V. The Arbitrator's Duties

In a world lacking global commercial courts of mandatory jurisdiction,[107] arbitration provides one way to bolster confidence in cross-border economic cooperation. Without binding private dispute resolution, many business transactions would remain unconsummated from fear of the other side's hometown justice. Or, they would be concluded at higher costs to reflect the greater risk due to the absence of adequate mechanisms to vindicate contract rights or investment expectations.

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28 I.L.M. 1109 (1989) (finding no host state liability when Italy requisitioned American-owned plant to prevent liquidation). See generally FA Mann, 'Foreign Investment in the International Court of Justice' (1992) 86 *Am. J. Int'l Law* 92.

[105] In this respect, several challenges have been rejected with respect to an arbitrator's membership on the board of a Swiss bank which managed pension funds whose portfolio contained shares of one of the parties. See, ICSID Case No. ARB/03/17 (claimant Suez, Aguas de Barcelona and Interagua Servicios), ICSID Case No. ARB/03/19 (claimant Suez, Vivendi and Aguas de Barcelona); ICSID Case No. ARB/03/22 (claimant Electricidad Argentina and EDFI), and ICSID Case No. ARB/03/23 (claimant EDF International S.A., SAUR International S.A. & León Participaciones Argentinas S.A.)

[106] In a dispute implicating a manufacturer of household appliances, an arbitrator who owns a dishwasher made by the manufacturer would present a very different position from that of an arbitrator who served as corporate secretary. An arbitrator who serves on the board of a company with 100,000 customers (one of whom has a link with an affiliate of the respondent) would pose different concerns from those obtaining if the respondent's affiliate was the principal customer.

[107] Regional bodies such as the European Court of Justice do exist in the context of treaties for economic union, but would have no authority, for example, in a dispute between a French Société Anonyme and an American corporation, or between a Chinese trading entity and a Brazilian Sociedad Limitada.

In consequence, conflicts of interest take on significance not only for the direct participants in cross-border trade and investment, but also for the wider global community whose welfare is directly affected by the arbitral process. Arbitration's broader impact raises propositions of whether an arbitrator's ethical obligations flow to society at large rather than simply to the litigants. The answer, perhaps unsatisfying to ideologues, remains 'sometimes'.

As an initial matter, one must be cautious about unselective attempts to transplant judicial standards into the world of arbitration. Given a judge's clear obligations to the citizenry as a whole, the calculus of judicial duties will differ from what might be expected of arbitrators who remain principally (albeit not exclusively) creatures of the litigants' contracts.

For example, if urged by parties mindful of costs, an arbitrator might accept proceedings with reduced due process, even if not willing to go so far as rolling dice or consulting chicken entrails. By contrast, a judge may not feel comfortable abandoning state-imposed procedural mandates, even if so requested by litigants seeking a cheaper and quicker process. The state that pays the judge's salary sets the broad contours of the relevant procedure. Of course, there are limits to what arbitrators will do at the request of parties. Few will condone arbitration as a tool for money-laundering[108] or proceedings designed to falsify what actually happened.[109]

In most instances, public and private goals will coincide, with each having a very real interest in the systemic integrity of the arbitral process. Seeking to decide disputes fairly as between the parties, arbitrators will normally adopt practices that comport with public concerns about basic procedural due process. The just enforcement of private contracts will normally promote the societal interest in promise-keeping and respect

[108] To move embezzled funds abroad, a corrupt official might conclude a contract with a foreign entity, controlled by the official's equally corrupt colleagues overseas. When the government fails to perform its obligations, arbitration (sometimes with honest arbitrators unaware of what has happened) would lead to an award whose execution ultimately implicates transfer of funds abroad. For one case in which such allegations surfaced (with warning signs constituted by entities not in existence when the contract was concluded), see *Gulf Petro Trading Co., Inc. v Nigerian National Petroleum Corp*., 512 F.3d 742 (5th Cir. 2008), discussed in Thomas Walsh, 'Collateral Attacks and Secondary Jurisdiction in International Arbitration' (2009) 25 *Arb. Int*. 133.

[109] A recent California case illustrates the potential for misuse of the arbitral process in employment law. *Nelson v American Apparel, Inc*. (Cal. App. 2d. Dist. 28 October 2008, No. B205937) implicated the founder of American Apparel, reported to have been the object of at least three sexual harassment lawsuits. In one, a strange piece of post-settlement theater involved payment of more than $1 million to an employee who apparently accepted a sham arbitration by a retired judge whose 'award' would stipulate facts and findings in the company's favor.

for bargains that underpin most cross-border commercial or financial cooperation.

Arbitrators thus bear a responsibility of the utmost seriousness to be mindful of the integrity of their proceedings when seeking an optimum balance between fairness and efficiency. Those who break faith with this duty make the world a poorer place.

A United Nations' Liaison Hub and Ombudsoffice for International Economic Relations: A Proposal

Chitra Radhakishun*

I. Introduction

Thomas Wälde was an outspoken person, happy to provoke, not afraid of being politically incorrect when he was convinced of being right. He loved launching ideas and stirring debates. It may therefore be befitting to put forward such a proposal in this *Liber Amicorum.* The informed reader will, I think, find that the proposal connects dots between initiatives that are slowly taking form in one way or the other.

This contribution is made under my personal responsibility, with none of what is written attributable to any organization or institution I am, or was, affiliated with.

II. A Not So Unorthodox Proposal?

International economic relations are increasingly governed by national, regional and international rules, laid down in a multitude of instruments, creating an international economic legal-regulatory entangled system. In this entangled system, stakeholders from the public and the private sector operate, secure commitments, try to enforce obligations and entitlements and preserve rights. Alongside these actors, United Nations bodies and other national and international institutions engage in activities related to furthering understanding and implementation of these rules. Within the United Nations, identifying the responsible bodies and their connection to related activities undertaken elsewhere in the system, and at a more basic level, which services could be provided by what body, is a difficult task for member States and other stakeholders alike. To illustrate with an example, officials from national or local government or communities, state lawyers or attorneys-general, NGOs,

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business associations or chambers of commerce and industry, have a hard time finding out if any body or bodies within the United Nations system, and if so, which ones, provide training and capacity building in a specific area of trade and investment, or assistance in negotiating international agreements, or counselling and advice in handling disputes.[1]

Within the international economic maze of rules and regulations, and under the various obligations to which penalties for non-observation of commitments may be attached, some stakeholders are more challenged than others to optimize benefits and minimize losses in international commercial activities. That stakeholders from developing countries are typically the weaker ones, needs no further explanation.

The multi-faceted challenges developing countries face, appear in the earliest stages of the process and can continue to the enforcement stages. Some of the frequently observed challenges are highlighted below.[2]

[1] For example, technical assistance on regional integration, investment and trade related issues is being provided by various United Nations bodies, and the differences in approach or in comparative advantages are not always clear. In the area of trade and development, the United Nations Conference on Trade and Development (UNCTAD) leads an Inter-Agency Cluster on Trade and Productive Capacity in which the United Nations Industrial Development Organization (UNIDO), the United Nations Development Programme (UNDP), the International Trade Centre (ITC), the Food and Agriculture Organization of the United Nations (FAO), the World Trade Organization (WTO), the five United Nations Regional Commissions, the United Nations Environment Programme (UNEP) and the United Nations Office for Project Services (UNOPS) participate. The objective is the coordination of trade and development operations at the national and regional levels within the United Nations system. Beyond trade, the One United Nations - approach, which is aiming at delivering United Nations products as one, is attempting the same within the so-called United Nations Development Group (UNDG). In the UNDG, 32 United Nations funds, programmes, agencies, departments, and offices that play a role in development, are united with the objective of delivering more coherent, effective and efficient support to countries seeking to attain internationally agreed development goals, including the Millennium Development Goals.

[2] These observations are confirmed by UNCTAD research. See for example: UNCTAD (2009), The Economic Development in Africa Report 2009: 'Strengthening Regional Economic Integration for Africa's Development', UNCTAD/ALDC/AFRICA/2009, New York and Geneva: United Nations; UNCTAD (2008), The World Investment Report 2008: 'Transnational Corporations, and the Infrastructure Challenge', UNCTAD/WIR/2008, New York and Geneva: United Nations; UNCTAD (2007), The Trade and Development Report 2007, 'Regional cooperation for development', UNCTAD/TDR/2007, New York and Geneva: United Nations; UNCTAD (2007), 'Globalization for Development: The International Trade Perspective', UNCTAD/DITC/2007/1, New York and Geneva: United Nations; UNCTAD (2007), Investor–State Dispute Settlement and Impact on Investment Rulemaking UNCTAD/ITE/IIA/2007/3, New York and Geneva: United Nations; UNCTAD (2004), 'Multilateralism and regionalism: The new interface', UNCTAD/DITC/TNCD/2004/7, New York and Geneva: United Nations; and reports of UNCTAD intergovernmental meetings on regional integration (www.unctad.org).
The author herself has observed these in her work as Manager of the UNCTAD Project on Dispute Settlement in International Trade, Investment and Intellectual Property. Arbitration practice confirms a number of these findings. For example, at the 14th Geneva
Cont.

A. Legal-Technical Obstacles.

These obstacles may appear when legal notions and drafting techniques applied were drawn from differing legal traditions. Typically, contracts and procedures grounded in common law principles and conventions where the host state observes the civil law traditions, may more easily lead to problems of interpretation. Examples presented at a recently held Arbitration Forum may be illustrative.[3] Russian arbitration practitioners raised the indivisible package of 'U.S.A. investment combined with American legal rules' as a major obstacle and a fertile breeding ground for disputes. German practitioners felt that the use of Common Law procedures in arbitral proceedings were among the principal causes for the increasing cost and duration of international arbitrations in Germany and, consequently, to a turning away from arbitration.

In this context, linguistic obstacles need to be considered. Although not frequently mentioned in international discussions, linguistic obstacles pose a challenge. There is an inherent inequality between parties when arrangements and contracts are negotiated and drafted in what is a foreign language for one party, especially when they involve technical legal notions. Subsequently, at the implementation stage, the linguistic capacity of officials, business partners from the private sector and even local management, will pose obstacles of varying degrees to effective communication with the foreign investor. While English may be widely used in international dealings, the use of this language is by no means universal. A further level of complexity may arise when the language used is a 'third' language for both parties. Further study on this obstacle may be indicated.

B. Obstacles Related to the Import and Consequences of Arrangements For Stakeholders

When arrangements enter into force, there may still be a lack of understanding of the import and consequences of commitments these arrangements carry, especially outside the circles of officials involved in the negotiating process. An example is the obligation World Trade Organization (WTO) membership carries for acceding states.

Understanding the import and consequences of arrangements and commitments, for example regarding the possible imposition of penalties, often poses obstacles in the implementation stages of the

Global Arbitration Forum in May 2009, Mr. Pierre Lalive, Swiss lawyer and arbitrator, mentioned a number of these obstacles in his presentation.

[3] First International Arbitration Forum, organized by the Chambre Européenne d'Arbitrage, 21 May 2009 Kiev, Ukraine.

agreement for stakeholders from the private sector, especially when their involvement was limited during the negotiating stages. Many developing countries have weak public-private sector communication structures. As a consequence, there is inadequate dissemination of information, including on the import and impact of concluded agreements on the business community.

Equally, national exporters are often not aware of possibilities for action that could be taken in their favour under international arrangements their governments became party to. For example, exporters may not be aware that the government can take up claims on their behalf when punitive tariffs are imposed on their products. A good example of change is the Indian Government's information campaign of 2009 to guide the private sector to governmental channels they can approach for exploring safeguard actions under WTO rules against dumping.

C. Obstacles Related to Monitoring and Management of Obligations

Lack of and/or weak administrative capacity at the governmental level is an important cause of weak and ineffective monitoring and management of obligations and commitments under the various arrangements states are party to. The ever increasing volume of commitments is further weakening the already weak capacity. The challenges are even more important, when, as is not uncommon, different departments and/ or levels of government are involved. The problems are compounded when the various arrangements the state is signatory to, embody different and even contradictory and conflicting rights and duties for the parties.

D. Dispute Management Obstacles.

What when disputes arise? The obstacles mentioned above, compounded by other factors, come to head at a point of crisis. Some of the more frequently observed challenges at the dispute management stage are highlighted.

Lack of capacity to manage a threatening dispute effectively, or to assume the obligations of a defendant, poses an obstacle on various fronts. The lack of capacity can become manifest in for example adhering to procedural rules. Lax observation of such rules, for example on time frames, could lead to missing deadlines, and thereby forfeiting rights, at times including even the right to initiate or continue arbitration or litigation on the specific issues. The lack of capacity to decide on the most effective dispute resolution strategy, including choosing the most appropriate forum under the concrete circumstances, opting for litigation

or alternative dispute resolution – arbitration, mediation, conciliation – but also to evaluate the associated cost-benefit-success ratios, may further compound the complexity of the matter at hand. The choice of forum is becoming more and more important, as the growing number of forums that can be accessed within the web of international and regional arrangements, provides as many challenges as opportunities.

Where different forums can be opted to settle disputes in the economic field, particularly on trade and investment related issues, factors such as the estimated chance of success under the relevant rules, cost aspects, or keeping open options to approach another forum, need to be given careful consideration. Governments may also weigh political concerns in their considerations, especially national and regional concerns.

E. Obstacles in Administrative Coordination

Ineffective administrative coordination poses a challenge to effectively pursue a strategy to resolve disputes. Clarity on which administrative, departmental, or governmental instance is to be in charge, poses hurdles. Local authorities may for example take a different stance from the central government on how to deal with the business partner. Disagreement on the strategy to pursue is likely to have a negative impact on resolution of the dispute.

Insufficient knowledge of applicable relevant and procedural rules, clarity on which instance is in charge and agreement on the line of action to pursue, form a toxic cocktail which puts especially developing countries at a disadvantage in the settlement of international economic disputes.

F. Obstacles Faced by the Business Community

There is often a lack of effective structures to assist the business community when disputes arise under regional or international arrangements. Developing countries in general do not have easily accessible channels to allow traders and/or investors to make use of entitlements under international schemes and to take claims to dedicated international forums. Many bodies, especially in international trade, are accessible to member states, with no direct access to the system for the business community. This holds for example, with respect to getting the government to take up claims, in the jargon, espouse claims, for submission to the WTO's dispute settlement bodies on behalf of exporters. The situation is different for foreign investors, who have direct access to the arbitration mechanism of the International Centre for Settlement of Investment Disputes (ICSID), if their governments

are parties to the ICSID Convention (which is a multilateral treaty). To date, the majority of developing countries are host countries for foreign investment, and consequently find themselves generally in the position of respondent rather than that of claimant in investment arbitration.

G. Obstacles in Securing Effective Legal Counsel

Many developing countries have limited information on commercially and non-commercially available legal counsel, the schedule of fees and terms of engagement, but also on their margin for negotiating the terms of engagement with the counsel. Many developing country officials find shopping for a lawyer to represent the state in an international dispute a challenging endeavour. This issue has been discussed on Thomas Wälde's electronic discussion and intelligence forum (on international dispute resolution and on commercial disputes in the energy and resources field, Oil-Gas-Energy-Mining-Infrastructure Dispute Management (OGEMID)).

Choosing legal counsel demands the capacity to assess the quality of the various legal services on offer. Criteria weighed in the comparison should typically include the experience, success rate and reputation of the lawyer or law firm as well as the cost of the service and the overall competitiveness of the package offered.

As a minimum, counsel should be able to give a prima facie assessment of chances to make a claim successfully, and the government official(s) in charge should have the capacity to evaluate this advice. Ideally, the counsel should put in the basket of options she or he presents, also amicable resolution, such as conciliation or mediation, or, in trade disputes, mutually agreed solutions. As regards the latter, it may be illustrative that out of 392 disputes brought to the WTO system for resolution between 1 January 1995 – April 2009, about 25% were settled by mutually agreed solution through consultations (or the dispute was resolved otherwise without recourse to adjudication).[4] The legal counsellor is well-placed and has substantial authority to forward conciliation or mediation as options in other commercial and investment disputes. Even though data on arbitration are not publicly available, evidence from practice suggests that not many lawyers are inclined to go that route, not least because conciliation and mediation are less lucrative as fee-generators for the lawyer in comparison to arbitration or litigation in international forums.

[4] See 'UNCTAD Course on Dispute Settlement in International Trade, Investment and Intellectual Property', Module 3., Overview, World Trade Organization, www.unctad.org/dispute.

H. Obstacles in securing aid at the dispute settlement stage

There are various organizations and institutions, both public and private, that provide legal aid in international disputes, under varying conditions, including within the United Nations system. However, developing countries have limited access to information on available international legal aid and on accessible support funds. The limited access to information is related to both the effectiveness of international organizations' information outreach as to the absence of tools and networks to obtain reliable and pertinent information at the user's end.

One example of a better known legal aid institution for international trade disputes, is the Geneva-based intergovernmental organisation Advisory Centre on WTO Law (ACWL). Established in 2001 with the stated objective of providing legal advice on WTO law and support in WTO dispute settlement proceedings, it has become a cost efficient and qualitatively competitive alternative to commercially available legal counsel for developing countries and least developed member states.

III. Key elements for a United Nations response

The many challenges faced in the international economic regulatory arena, not least by the weaker stakeholders, notably the developing countries, call for an effective response. In my view, the United Nations is the only international institution that can adequately provide a response to meeting the challenges described above.

A three-pronged response is proposed:

1. Negotiating the Maze: The creation of a one-stop support, liaison and guidance facility, as a first step to facilitate navigation through the currently existing maze of international economic laws, regulations and arrangements;
2. Legal Aid: The establishment of a one-stop guidance facility to direct stakeholders to available legal aid, and extension of legal aid resources for weaker international players – primarily, but not exclusively, states – in international economic disputes;
3. A United Nations Ombuds-office: The creation of a United Nations ombuds-office for facilitated mediation in international economic disputes.

A. Support, Liaison, Guidance and Legal Aid

The proposed support, liaison and guidance facility would have as its objective helping member states navigate the complex international

economic legal-regulatory maze.[5] It may be modelled upon the *Rule of Law* facilities launched since 2004 by the United Nations Secretariat.[6] Work on the Rule of Law was proposed because it was felt that the organization needed to deepen and rationalize its rule of law work, and coordinate more effectively with outside actors. To date, this work is limited to four pillars of the modern international legal system, namely international human rights law, international humanitarian law, international criminal law and international refugee law.

As seen above, similar needs exist in the area of international economic law. Hence, the proposed United Nations support, liaison and guidance facility could have a similar structure in the area of international economic law, focusing on trade and investment. The facility would act as a navigation tool to reach the international body or bodies that could most adequately provide the service, assistance or information sought.

Similar to activities coordinated by the United Nations' Rule of Law secretariat, the facility could gather data and disseminate information, maintain a central website and/or provide links to bonafide websites, as well as a calendar of activities including of training and capacity building activities relevant to international economic law. It could provide guidance to governments, the business community and to non-state actors on where to find assistance in international negotiations, or on how to choose a lawyer or arbitrator, and on where to source international financial or non-financial aid for the settlement of international disputes. The latter task would feed into the second facility proposed, namely the legal aid facility.

The proposed facility should also provide a forum where actors and stakeholders from national and international bodies and from governments, such as government and private sector legal officers, attorneys-general, representatives of bar associations and associations of arbitrators, providers of national and international legal aid, and of training and capacity building, could meet to exchange information and experience.

B. Legal Aid

Proposals for providing international legal aid keep resurfacing in one form or the other. A one-stop United Nations facility for legal aid would have as its first task taking stock of existing activities and initiatives. On

[5] Some of the functions proposed are currently being undertaken by UNCTAD.

[6] Rule of Law Coordination And Resource Group, Joint Strategic Plan 2009–2011, United Nations, February 2009; Strengthening and coordinating United Nations Rule of Law Activities, Report of the Secretary-General, United Nations, 6 August 2008, A/63/226.

the basis of the existing structures, proposals could be made for creating an integrated and easily accessible international legal aid structure.

C. The United Nations Ombuds-Office

This proposal calls for the creation of a United Nations ombuds-office for international economic disputes. The ombuds-office is proposed as an alternative and affordable solution to the increasing difficulties weaker players in general and developing countries in particular encounter in international arbitration. This ombuds-office would combine the moral authority of the United Nations with the more affordable forms of dispute settlement and alternative dispute resolution (ADR) increasingly being discussed in arbitration circles, namely conciliation and mediation.

The ideal shape of the United Nations ombuds-office needs to be carefully considered. One possibility might be to establish a twin-headed ombuds-office. In this structure, the two ombudspersons could represent developing and industrialized countries respectively, and also the two main legal traditions, namely common law and civil law. Such a structure would provide essential options to the member states seeking its services from the very outset.

The principal role of the United Nations ombudsoffice would be to act as a mediator in differences, disagreements and disputes. The aim would be to achieve an amicable solution and to avoid, where possible, increasingly costly and often lengthy international litigation, or institutionalized or ad hoc arbitration. The ombudsoffice would promote discussion between the parties and mediate between the parties to reach a mutually agreed solution. Ideally, the ombudsoffice would achieve fair and equitable outcomes in international economic disputes.

The symptoms witnessed in international economic relations, from international legal frictions and disputes, especially in investment, trade and commercial transactions, to the explosion of feverish legal activities provided by a variety of commercial and non-commercial service providers and associations, indicate a need for action. In international matters, where the international community holds responsibility, the only multilateral organization that can provide legitimate leadership, create a viable structure for helping member states navigate the complexities of the present tangled system and achieve fair and equitable outcomes in international economic disputes, is the United Nations.

Courts and Arbitration: Forming Choices for Young Lawyers

Klaus Reichert*

I. Introduction

Thomas Wälde (RIP) encouraged many (if not all) those lawyers who were privileged to have met him to challenge easy assumptions about the law and its practice. Not for him were sacred cows; if a clanging bell needed to be sounded or a discordant note needed to be played, Thomas did so without fear or favour. The world of international arbitration is significantly better off as a result. From this writer's memories of Thomas, it would be fair to say that nothing would have appalled him more than cosy acceptances of the *status quo*.

Secondly, his keen interest in the development of young lawyers starting out in practice was, perhaps, one of his most enduring legacies as was shown by the vast number of email tributes which poured through OGEMID in the dark days following his untimely death. Thomas, by his work and debates (fuelled by his firm grasp of his trusty BlackBerry), imbued many with an interest in arbitration and international law – and he was tireless in giving encouragement and recommendations for young practitioners. His mentoring of so many practitioners has enriched the law.

II. Court Support for Arbitration

A regular feature of arbitration conferences or papers in journals or legal marketing literature is the expression *Court Support for Arbitration* adopting a mantra that the courts of whatever country is being pushed by the speaker or writer will blithely and unquestioningly 'support' the arbitration process. One could almost imagine such conferences as being the same as an Eastern Europe communist party annual meeting circa 1971 (taking into account the adjustment for hair and clothes) where speaker after speaker proclaims the ever-greater success of the current five-year plan to ranks of nodding delegates.

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Why should this mantra be in our lexicon? Why should it be accepted? Why is it so? Is it true? Shortly before writing this paper an email advertising a seminar in London was received and it concerned a review of the latest developments under the English Arbitration Act 1996. One of the points made in this email was that over 1,000 decisions had been rendered by the English Courts on the Arbitration Act 1996 since its coming into force just over twelve years ago. 'Why so many' was the thought which came to this writer. The Arbitration Act 1996 is longer, more detailed and eminently readable than many other arbitration laws. Why then have there been so many outings under its auspices to the English Courts?

III. Young Lawyers and the Practice of International Arbitration

A further feature of the contemporary arbitration world is (to this writer's perception) a desire by many young lawyers to immediately enter the field of international arbitration and by-pass domestic practice. While it is certainly the case that there are many established arbitration practitioners who work exclusively in the international field, there are many more who combine such practice with other work in their home jurisdiction. However, it is most likely that almost all such practitioners trace their working lives back to a firm and thorough grounding in the jurisdiction where they did their original training. There are, of course, exceptions to all such statements, but having taken a rough and ready straw poll of many colleagues it seems to be the case that life in the law started with a wide and diverse range of court cases (not all of them big) and other domestic work. A further characteristic which seemed to emerge in the unscientific straw poll was a gradual shift towards international arbitration as the person's practice developed. In very few instances did the response indicate that international arbitration was the first and only discipline on the desk from day one.

Why, therefore, do so may newly qualified (or about-to-be-qualified) lawyers wish to immediately enter what is colloquially referred to as the international arbitration bar? The answer is, of course, quite obvious. Apart from the prospect of debating fascinating legal points of international law (as one famous practitioner puts it (amended slightly for print) – *to show how ... clever you are*) in seemingly glamorous locations, there are very few areas of legal practice for the internationally-minded lawyer to truly ply their profession across jurisdictional boundaries. The vast growth (until recently at least) in wealth throughout the World, the greater ease of travel and study, has greatly increased the numbers entering the legal profession. No longer are the top law firms citadels for 'old boy' networks rooted in single countries. The huge numbers of

students from across the Globe undertaking LLM programmes and the success, for example, of the annual Vis Moot in Vienna, have ensured an interest in international arbitration practice not experienced to date. This has corresponded with a branching out of many law firms (both international and domestic) into the field and, by implication, an increase in the demand for lawyers to fill the new departments.

Perhaps, therefore, it is appropriate, in the spirit of Thomas, to pose the following questions:

Is it a good thing for a young and newly-qualified lawyer to immediately place all their eggs in the international arbitration basket? Do they really need to bother with mundane practice in domestic courts doing, for example, boundary disputes, debt collection, criminal defence work and so on?

IV. The Intersection of these Questions

What, it might be said, do these two disparate conundrums (Courts/ Arbitration, and young lawyers entering the field) have in common? The short answer is that: the role of the courts in arbitration is actually much more extensive than one (being an arbitration purist) might readily wish to believe or accept, and therefore a thorough grounding in litigation is an essential string to the bow of the young practitioner with ambitions in the international field.

As with all short answers to complex questions, there must follow a justification.

V. The Court's Role

While many studies examine in appropriate successive chapters the role of courts in the arbitral process, this paper will look, in one swathe, the entire spectrum of possible 'interventions' by a court in an arbitration. The extent of the role of the court may well come as a surprise when one sees, in one narrative, all the judicial powers in arbitration laid end to end.

The prism through which to view the court's role in the arbitration process for the purposes of this paper is the UNCITRAL Model Law on International Commercial Arbitration as it is the most international of statements on a legal framework for the process. It is, of course, interesting, that several of the most important arbitration venues, France, Switzerland and England (just to name a few) have not adopted the Model Law in as express a manner as other countries; however

for the purpose of this paper the Model Law provides the most useful indicator of how competences are divided up between the tribunal and the court throughout the arbitration process. This article will not look at the substantive detail of the law on each particular intersection of the court and the Model Law, rather it will highlight the practical procedural issues which might confront a lawyer.

Before examining the Model Law for each occasion when a national court may become involved in the arbitration process, it is necessary to set out why, in fact, the courts have any role at all.

> The intersecting interests in efficiency and minimization of national judicial interference in international arbitrations must strike an exceedingly fine balance between arbitral autonomy and a minimum competence for national judicial review. Too much autonomy for the arbitrator creates a situation of moral hazard. If abuses occur, and the theory of moral hazard holds that they are more likely to in the absence of controls, national courts will become increasingly reluctant to grant what amounts to a preferred, fast-track enforcement of awards. But too much national judicial review will transfer real decision power from the arbitration tribunal, selected by the parties in order to be non-national and neutral, to a national court whose party neutrality may be considerably less so. Each of these possible developments would ultimately reduce the attractiveness of arbitration as a private means of dispute resolution.[1]

These words were written in 1992 in the context of a study on, amongst others, the mechanism of enforcement of awards under the New York Convention. These words have equal authority in the context of the international arbitration process as a whole and resonate today as much as they did in 1992.

From a different source[2] comes a broader analysis of why courts are involved in the arbitration process and why the Model Law draws its lines where it does:

> **Delimitation of court assistance and supervision**
>
> 15. Recent amendments to arbitration laws reveal a trend in favour of limiting and clearly defining court involvement in international commercial arbitration. This is justified in view of the fact that the parties to an arbitration agreement make a conscious decision to exclude court jurisdiction and prefer the finality and expediency of the arbitral process.

[1] W Michael Reisman, *Systems of Control in International Adjudication & Arbitration* (Duke 1992) 113

[2] Explanatory Note by the UNCITRAL Secretariat on the Model Law on International Commercial Arbitration

> 7. Beyond the instances in these two groups, 'no court shall intervene, in matters governed by this Law'. Article 5 thus guarantees that all instances of possible court intervention are found in the piece of legislation enacting the Model Law, except for matters not regulated by it (for example, consolidation of arbitral proceedings, contractual relationship between arbitrators and parties or arbitral institutions, or fixing of costs and fees, including deposits). Protecting the arbitral process from unpredictable or disruptive court interference is essential to parties who choose arbitration (in particular foreign parties).

It is worth repeating the following aspiration: '[P]rotecting the arbitral process from unpredictable or disruptive court interference is essential to parties who choose arbitration'. Is this actually achieved by the Model Law? The starting point certainly sounds the right note with Article 5:

> **Article 5: Extent of court intervention**
> In matters governed by this Law, no court shall intervene except where so provided in this Law.

It is the *except where so provided* which gets the attention and makes it clear that only in the prescribed situations may a national court involve itself in an arbitration. Inherent jurisdictions are swept away, and rightly so.

The Model Law moves on, with a technical Article designating the court:

> **Article 6: Court or other authority for certain functions of arbitration assistance and supervision**
> The functions referred to in articles 11(3), 11(4), 13(3), 14, 16(3) and 34(2) shall be performed by ... [Each State enacting this model law specifies the court, courts or, where referred to therein, other authority competent to perform these functions.]

The first substantive role of the courts prescribed in the Model Law is more in the way of a negative duty. However it is one with enormous practical importance, namely the obligation to stay proceedings which are the subject of an arbitration agreement:

> **Article 8: Arbitration agreement and substantive claim before court**
> (1) A court before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so requests not later than when submitting his first statement on the substance of the dispute, refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed.
> (2) Where an action referred to in paragraph (1) of this article has been brought, arbitral proceedings may nevertheless be commenced or continued, and an award may be made, while the issue is pending before the court.

The first point to be made is that experience shows that parties are often quick to disregard their previously entered into contractual arrangements when a dispute breaks out and, if a perceived advantage can be secured by bringing proceedings in a particular court, then such proceedings will be brought. Idealism and theories of arbitration evaporate in the face of litigants wishing to gain any possible advantage.

What steps have to be taken when seeking to stay court proceedings brought in the teeth of an arbitration clause? Depending on the particular jurisdiction one will have to immediately find out whether there are any default provisions in the local rules in order to avoid summary judgment. Secondly, one has to know exactly how one can go on the record and still preserve the client's right to arbitrate. Thirdly, one has to know exactly what the local interpretation is of *not later than when submitting his first statement on the substance….* Fourthly, one has to know what is the exact mechanism by which, one 'requests' the court to refer the matter to arbitration. It is this last issue which can cause untold difficulties downstream in arbitration as there is, in many countries, a requirement that the party seeking the reference to arbitration has to set out some factual account of the background and place of the relevant agreement before the court. Even if this is done in the most skeletal of fashions, there are still factual markers being laid down. These may well have been done in some haste (to avoid default) and before the case is fully known to either the party or its counsel. Those factual markers will be very awkward to avoid later on in the arbitration and back-tracking will not be either edifying or easy.

Very often there will be considerable opposition by the party which brought the court proceedings in the first place and creative thought will be given by its lawyers to construction of arguments to invoke *null and void, inoperative or incapable of being performed.* While such arguments are often doomed to failure, they do draw both sides into a factual contest which a court has to decide.

A further area where the court can adjudicate upon an important issue in such circumstances is whether, in fact, the parties agreed to arbitration. One often overlooks the fact that Article 8 requires, as a pre-condition to its operation, an arbitration agreement between the parties. This can involve examination of the ingredients of the formation of a valid contract between the parties and, again, while often doomed to failure, the recalcitrant party will put the other side to the test. Given the absolute requirement of a valid agreement to arbitrate for there even to be an arbitration and also the well-established position that arbitrators are not the final decision-makers on their own jurisdiction, one can very easily see the possibility that a detailed hearing (quite often with oral

witness testimony) on the existence of the arbitration agreement can take place in a court room at the outset.

One has to note at this stage that France has a well-known approach of negative competence which defers this examination to the end of the arbitration.

Much will depend on the robustness of the court concerned and the procedural rules applicable; however one can say that applying successfully to stay court proceedings in favour of arbitration is neither particularly easy nor is it without danger. It is very difficult not to stray into matters of substance and positions taken or testimony given at such an early stage may be awkward or difficult to explain at a later stage in the process!

> **Article 9: Arbitration and interim measures by court**
> It is not incompatible with an arbitration agreement for a party to request, before or during arbitral proceedings, from a court an interim measure of protection and for a court to grant such measure.

This is a short Article but has, within it, the potential for enormous and time-consuming procedures before the court. If a party requires, or manufactures through either clever correspondence or contrived arguments, an injunction or other temporary relief from a court 'in aid' of the arbitration, Article 9 provides the legal avenue for such person.

Invariably some description or verification of the factual background has to be placed before the court in order to demonstrate an entitlement to an injunction or similar order. This will require, amongst others, a knowledge of the procedural rules for the court in question, what format does the application have to conform to, what standard of evidence or proof is required, is there a doctrine of utmost good faith to fully and frankly tell the whole story, and so on.

This Article has also the potential for the creation of epic and public battles in court rooms where matters of substance are debated. As with an argument about the existence of an arbitration agreement, one can readily see circumstances where factual positions are taken in the white-heat of an injunction battle which may well cause discomfort down-stream in the arbitration when there is more time to reflect upon what the parties did or did not do during their contractual relationship.

A further consequence is that injunctions can, notwithstanding how their terms are dressed up to be expressed as 'in support' of the arbitration, have significant practical consequences. Bank accounts can be frozen,

documentation is preserved (if not handed over), assets neutralized and so on. The dynamic of a dispute may be irretrievably changed in such circumstances. The 'dynamic' of a case is an intangible element not easily described or taught, but for all experienced lawyers it is one of the most fundamental aspects of success or failure.

> **Article 11: Appointment of arbitrators**
> (3) Failing such agreement, (a) in an arbitration with three arbitrators, each party shall appoint one arbitrator, and the two arbitrators thus appointed shall appoint the third arbitrator; if a party fails to appoint the arbitrator within thirty days of receipt of a request to do so from the other party, or if the two arbitrators fail to agree on the third arbitrator within thirty days of their appointment, the appointment shall be made, upon request of a party, by the court or other authority specified in article 6;
> (b) in an arbitration with a sole arbitrator, if the parties are unable to agree on the arbitrator, he shall be appointed, upon request of a party, by the court or other authority specified in article 6.
> (4) Where, under an appointment procedure agreed upon by the parties, (a) a party fails to act as required under such procedure, or (b) the parties, or two arbitrators, are unable to reach an agreement expected of them under such procedure, or (c) a third party, including an institution, fails to perform any function entrusted to it under such procedure, any party may request the court or other authority specified in article 6 to take the necessary measure, unless the agreement on the appointment procedure provides other means for securing the appointment.
> (5) A decision on a matter entrusted by paragraph (3) or (4) of this article to the court or other authority specified in article 6 shall be subject to no appeal. The court or other authority, in appointing an arbitrator, shall have due regard to any qualifications required of the arbitrator by the agreement of the parties and to such considerations as are likely to secure the appointment of an independent and impartial arbitrator and, in the case of a sole or third arbitrator, shall take into account as well the advisability of appointing an arbitrator of a nationality other than those of the parties.

This Article has the mundane appearance of a procedural fall back for the parties to the court if they cannot agree (in an *ad hoc* case) on the constitution of the arbitral tribunal. However, as with every Article in the Model Law one should never underestimate the potential importance of every aspect of a dispute resolution process. As with any other application to a court in respect of an arbitration the lawyer will have to know all the necessary procedural steps to take, the form of the documents, what level of proof is required and so on. There may be, as with many legal systems, delays in the rendering of a final decision and, as often is the case, a row between the parties as to what considerations the court should take into account when appointing the arbitrator. This again can severely impact upon a party which to have its case dealt with promptly.

> **Article 13: Challenge procedure**
> (3) If a challenge under any procedure agreed upon by the parties or under the procedure of paragraph (2) of this article is not successful, the challenging party may request, within thirty days after having received notice of the decision rejecting the challenge, the court or other authority specified in article 6 to decide on the challenge, which decision shall be subject to no appeal; while such a request is pending, the arbitral tribunal, including the challenged arbitrator, may continue the arbitral proceedings and make an award.

This Article affords the right to a party which is disappointed with a rejection of a challenge to an arbitrator to go to court and have the matter decided. Again it demonstrates that arbitrators, or arbitral institutions with procedures for dealing with challenges, do not have the last word on the matter. That is reserved for the court and provides, according to the Model Law's structure, another example of the *fine balance between arbitral autonomy and a minimum competence for national judicial review*.

Given the potential for serious disruption of the process (despite the ability of the arbitral tribunal to continue with the case – though in reality one often sees such challenges bringing an arbitration to a procedural halt) the lawyer will have to be keenly aware of all the usual issues involved in such a court application – procedural requirements, burden and form of proof, oral or written argument and so on and so forth.

> **Article 14: Failure or impossibility to act**
> (1) If an arbitrator becomes de jure or de facto unable to perform his functions or for other reasons fails to act without undue delay, his mandate terminates if he withdraws from his office or if the parties agree on the termination. Otherwise, if a controversy remains concerning any of these grounds, any party may request the court or other authority specified in article 6 to decide on the termination of the mandate, which decision shall be subject to no appeal.

This could be described as the panacea for the 'disappearing arbitrator' – parties cannot be expected to tolerate a situation whereby an arbitrator sits on his or her hands for an inordinate period of time, or where the arbitrator has, for example, gone insane. What is interesting about this Article is that it does not defer to the parties' agreement on procedure (such as by electing for institutional rules) for removal but seems to give a direct right of application to the court. All of the comments made already in this paper about knowing how to apply, the standards of proof, the manner in which the application is to be run, and so on, are similarly applicable.

> **Article 16: Competence of arbitral tribunal to rule on its jurisdiction**
> (3) The arbitral tribunal may rule on a plea referred to in paragraph (2) of this article either as a preliminary question or in an award on the merits. If the arbitral tribunal rules as a preliminary question that it has jurisdiction, any party may request, within thirty days after having received notice of that ruling, the court specified in article 6 to decide the matter, which decision shall be subject to no appeal; while such a request is pending, the arbitral tribunal may continue the arbitral proceedings and make an award.

Without agreement (whether express or implied) arbitrators are nothing more than passing strangers without authority. The doctrine of *kompetenz-kompetenz* enshrined in Article 16 of the Model Law does reflect the entirely sensible power of arbitrators to rule on their jurisdiction. Without such a power the arbitral process would grind to a halt as every time a jurisdiction issue arose the parties would have to switch to the relevant court for a decision. That would be an utterly nonsensical (though profitable for lawyers) proposition. However, an arbitral tribunal cannot have the last word on jurisdiction. That is a proposition firmly rooted in arbitration law and no-one could now seriously challenge its primacy.

What, though, does this mean in practical terms? Effectively the court must conduct a full review of the issue as to whether or not the parties conferred jurisdiction on the tribunal through the arbitration agreement. The court is not acting as an appeal body from the award; rather it has to come to its decision unconstrained by the findings of the tribunal – a rehearing from the ground up. Of course the court can have regard to the award as a persuasive element in the evidential contest, with more weight being given to a highly detailed and compellingly-reasoned decision and less weight to a bare award expressing conclusory findings. Thus, the lawyer must be prepared for a full contest, like any other dispute on the merits before the court, as to whether there is jurisdiction conferred upon the arbitral tribunal.

Disentangling jurisdiction from the merits of the case is not always easy and, as with many other issues identified in this paper, there may be awkward positioning which will not be easy to disavow at a later date before the tribunal if jurisdiction is upheld. Secondly, the court may well stray into findings on issues of substance (which are so close to issues of jurisdiction) that one may find further awkward moments before the tribunal when one side says that an issue has become *res judicata*!

A further element to a jurisdiction issue before the court under Article 16 is the real risk, quite often, that live witness testimony is required in order to ascertain what the relevant parties meant if documentation is

equivocal. Unless one has a particularly vigilant judge who knows with complete clarity where the line lies between matters of substance on the dispute and matters relating to jurisdiction, questioning can often elicit answers which can later be deployed in the arbitration (assuming the court upholds jurisdiction).

Article 17 H: Recognition and enforcement
(1) An interim measure issued by an arbitral tribunal shall be recognized as binding and, unless otherwise provided by the arbitral tribunal, enforced upon application to the competent court, irrespective of the country in which it was issued, subject to the provisions of article 17 I.
(2) The party who is seeking or has obtained recognition or enforcement of an interim measure shall promptly inform the court of any termination, suspension or modification of that interim measure.
(3) The court of the State where recognition or enforcement is sought may, if it considers it proper, order the requesting party to provide appropriate security if the arbitral tribunal has not already made a determination with respect to security or where such a decision is necessary to protect the rights of third parties.

Article 17 I: Grounds for refusing recognition or enforcement
(1) Recognition or enforcement of an interim measure may be refused only:
(a) At the request of the party against whom it is invoked if the court is satisfied that:
(i) Such refusal is warranted on the grounds set forth in article 36(1)(a)(i), (ii), (iii) or (iv); or
(ii) The arbitral tribunal's decision with respect to the provision of security in connection with the interim measure issued by the arbitral tribunal has not been complied with; or
(iii) The interim measure has been terminated or suspended by the arbitral tribunal or, where so empowered, by the court of the State in which the arbitration takes place or under the law of which that interim measure was granted; or
(b) If the court finds that:
(i) The interim measure is incompatible with the powers conferred upon the court unless the court decides to reformulate the interim measure to the extent necessary to adapt it to its own powers and procedures for the purposes of enforcing that interim measure and without modifying its substance; or
(ii) Any of the grounds set forth in article 36(1)(b)(i) or (ii), apply to the recognition and enforcement of the interim measure.
(2) Any determination made by the court on any ground in paragraph (1) of this article shall be effective only for the purposes of the application to recognize and enforce the interim measure. The court where recognition or enforcement is sought shall not, in making that determination, undertake a review of the substance of the interim measure.

These Articles arose out of the long-running saga at UNCITRAL concerning interim measures. Ultimately, in 2006, a compromise was reached and a system for enforcement through the mechanism of the court was agreed upon. While these Articles represent new ground for arbitration law and one has precious little available in arbitration literature to give an indication of how these work in practice, one can see that it has the potential for much argument before the court in which enforcement is sought.

Even though the grounds for refusal of enforcement are confined, there is enough wriggle room and possibilities for disputing enforcement to ensure a lively and complex exchange in the court room.

A further, and perhaps unintended consequence of this Article, is the possibility for the defendant to do a dry run of Article 36 defences – which also require a detailed knowledge of what 'furnish proof' means as a matter of the particular jurisdiction's evidential and procedural rules. Certainly if a jurisdiction point is taken under Article 36(1)(a)(i) then a rehearing is required with all the concomitant evidential issues arising.

> **Article 17 J: Court-ordered interim measures**
> A court shall have the same power of issuing an interim measure in relation to arbitration proceedings, irrespective of whether their place is in the territory of this State, as it has in relation to proceedings in courts. The court shall exercise such power in accordance with its own procedures in consideration of the specific features of international arbitration.

This is not dissimilar to Article 9 which has already been dealt with earlier in this paper. What is worth mentioning is the attempt to reconcile 'in accordance with its own procedures' with 'in consideration of the specific features of international arbitration'. Quite what this means in practice and how one would engage a court on this issue, remains unclear.

> **Article 27: Court assistance in taking evidence**
> The arbitral tribunal or a party with the approval of the arbitral tribunal may request from a competent court of this State assistance in taking evidence. The court may execute the request within its competence and according to its rules on taking evidence.

This is, possibly, a fairly innocuous Article as the tribunal acts as a gate-keeper. It will, however, require a detailed knowledge of the actual procedures of the courts of the seat in regard to evidence-taking in order to set out for the tribunal what exactly can be done and why it should

be done. A sane tribunal will not simply open the gate on a say-so; the tribunal will need to know why the evidence is relevant and material, what will be involved in the court application, how long it will take, and whether it will lead to anything of substance.

> **Article 34: Application for setting aside as exclusive recourse against arbitral award**
> (1) Recourse to a court against an arbitral award may be made only by an application for setting aside in accordance with paragraphs (2) and (3) of this article.
> (2) An arbitral award may be set aside by the court specified in article 6 only if:
> (a) the party making the application furnishes proof that:
> (i) a party to the arbitration agreement referred to in article 7 was under some incapacity; or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of this State; or
> (ii) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case; or
> (iii) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the award which contains decisions on matters not submitted to arbitration may be set aside; or
> (iv) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, unless such agreement was in conflict with a provision of this Law from which the parties cannot derogate, or, failing such agreement, was not in accordance with this Law; or
> (b) the court finds that:
> (i) the subject-matter of the dispute is not capable of settlement by arbitration under the law of this State; or
> (ii) the award is in conflict with the public policy of this State.
> (3) An application for setting aside may not be made after three months have elapsed from the date on which the party making that application had received the award or, if a request had been made under article 33, from the date on which that request had been disposed of by the arbitral tribunal.
> (4) The court, when asked to set aside an award, may, where appropriate and so requested by a party, suspend the setting aside proceedings for a period of time determined by it in order to give the arbitral tribunal an opportunity to resume the arbitral proceedings or to take such other action as in the arbitral tribunal's opinion will eliminate the grounds for setting aside.

This is the final and ultimate control exercised by the court over the award and corresponds, broadly, with Article V of the New York Convention.

For the supervisory court and for the lawyer for the disappointed party, the starting point is what does 'furnishes proof' mean? Clearly the answer to that question must depend on what particular Sub-Article one is relying upon and it is not, frankly, for the court or for the Model Law to advise the litigant as to their proofs. However, it seems to be generally accepted that the standard is the balance of probabilities, being a civil standard, rather than any higher standard one would associate with crime, tax or fraud.

In any event, given the deadline for the making of a set-aside application is a fairly short one, there is often a rush to assemble the documentation for the court challenge. Translations may well have to be made (many arbitrations are conducted in English in cities where the language of the supervisory courts is different), liaising with local counsel, preparation of witness statements and so on and so forth, all would contribute to the significant practical burden on the disappointed party wishing to challenge the award.

Depending on the ground of challenge, particularly that of jurisdiction, the possibility of a rehearing by the court unfettered by (though not blind to) the findings of the tribunal on the necessary facts is plain to see.

> **Article 35: Recognition and enforcement**
> (1) An arbitral award, irrespective of the country in which it was made, shall be recognized as binding and, upon application in writing to the competent court, shall be enforced subject to the provisions of this article and of article 36.

This is a simple Article corresponding with the provisions of the New York Convention. It is a relatively simple element of the court's role in arbitration and is mechanistic. However, it is still necessary to understand the procedure prescribed by the court's rules for the successful making of an enforcement application.

> **Article 36: Grounds for refusing recognition or enforcement**
> (1) Recognition or enforcement of an arbitral award, irrespective of the country in which it was made, may be refused only:
> (a) at the request of the party against whom it is invoked, if that party furnishes to the competent court where recognition or enforcement is sought proof that:
> ...[broadly reflecting Article 34]
> (2) If an application for setting aside or suspension of an award has been made to a court referred to in paragraph (1)(a)(v) of this article, the court where recognition or enforcement is sought may, if it considers it proper, adjourn its decision and may also, on the application of the party claiming recognition or enforcement of the award, order the other party to provide appropriate security.

This is the other side of the Article 34 coin and the same comments apply in this context as regards the requirements of 'furnishes ... proof'.

VI. Conclusion

It is simply not the case that the court has a cameo role in arbitration. This is a conclusion which is inescapable when all the foregoing possibilities from the Model Law are laid out end to end. This substantial role of courts is also borne out in practice.

The court's role in arbitration is of great significance and, to answer one of the questions posed at the start of this paper, it is not a supportive one, rather it is considerably more extensive. For good or for ill the international standard for arbitration laws gives the court ultimate control over some of the most important aspects of the arbitral process, and, under the guise of the 'supportive' role in areas such as interim measures lies the practical potential for substantive decision-making by the judge.

The true picture may well be that the resolution of a dispute from beginning to end through the means of arbitration is a continuum of steps where the arbitral tribunal and the courts each undertake particular roles at different times. Sometimes the courts are not required due to sensible parties engaging with learned and efficient arbitrators; on the other hand the World is replete with experiences of the dysfunctional arbitration with parties jockeying for every possible perceived or real procedural advantage by engaging the courts in any of the many opportunities open via the Model Law.

If anyone doubted the real importance of the courts for arbitration then a recent Green Paper[3] published by the European Commission on the current review of Council Regulation (EC) 44/2001 (the 'Brussels Regulation' on jurisdiction and enforcement of judgments) will quickly bring such a person to their senses.

The Green Paper poses (question 7) the following under the heading *The interface between the Regulation and arbitration*:

> Which action do you consider appropriate at Community level:
> - To strengthen the effectiveness of arbitration agreements;
> - To ensure a good coordination between judicial and arbitration proceedings;
> - To enhance the effectiveness of arbitration awards?

[3] Brussels, 21.4.2009, COM(2009) 175 final, Green Paper on the Review of Council Regulation (EC) No 44/2001 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters.

One might ask why would there even be consideration of such questions in the context of a Regulation dealing with harmonizing rules on jurisdiction in Europe and the enforcement of judgments? The arbitration exception in the Brussels Regulation and its predecessor, the Brussels Convention, has worked (albeit not without the very occasional hiccough) well for some forty years. Nonetheless the abolition of the exception for arbitration is now firmly on the cards within the sphere of the European Union. The following extracts from the Green Paper give some insight into the thinking behind this proposal:

> Arbitration is a matter of great importance to international commerce. Arbitration agreements should be given the fullest possible effect and the recognition and enforcement of arbitral awards should be encouraged. The 1958 New York Convention is generally perceived to operate satisfactorily and is appreciated among practitioners. It would therefore seem appropriate to leave the operation of the Convention untouched or at least as a basic starting point for further action. This should not prevent, however, addressing certain specific points relating to arbitration in the Regulation, not for the sake of regulating arbitration, but in the first place to ensure the smooth circulation of judgments in Europe and prevent parallel proceedings.
>
> Next, a deletion of the exception might allow the recognition of judgments deciding on the validity of an arbitration agreement and clarify the recognition and enforcement of judgments merging an arbitration award. It might also ensure the recognition of a judgment setting aside an arbitral award. This may prevent parallel proceedings between courts and arbitral tribunals where the agreement is held invalid in one Member State and valid in another.

This paper is not the occasion to engage in a critique of the European Commission's views on whether the arbitration exception should be removed or not; that is the task of others and in other *fora*. The point though for present purposes is that the Green Paper signals a desire on the part of law makers whose geographical area includes London, Paris, Stockholm, Madrid, Frankfurt and Vienna (a modest selection of arbitral venues) to add to the court's potential role in the field of arbitration as that, it seems to this writer, to be the inevitable consequence of what is being proposed. The necessity, therefore, for the arbitration lawyer to have a knowledge of the court's processes and methods is therefore increased.

The conclusion of this paper brings one to the second set of questions posed and one of the great interests of the late Thomas Wälde, namely, the encouragement and development of young lawyers entering the profession and, in particular, the field of international arbitration.

In this writer's view it is most unwise for any young lawyer to immediately concentrate on international arbitration to the exclusion of everything else. As is clear from the analysis of the Model Law the role of the court in arbitration is, in fact, much more significant and important than sometimes might be believed to be the case. Thus, a young lawyer who does not have hands-on experience of the court room may well, despite an encyclopaedic knowledge of international arbitration law, suffer as a result. The process of international arbitration requires a full understanding by the lawyers practicing it of the intricacies of the court process in both the seat and of any country where enforcement may become a live issue. It is, of course, true that this information is usually conveyed by local counsel in the relevant jurisdiction. However it is also true that if the practitioner has never darkened the door of a courtroom their feel for the litigious process will be significantly less. Thus, for the young lawyer starting out in the field of international arbitration, the message should be that a thorough grounding in litigation is an integral part of developing their arbitral practice.

Investment Treaties and the Russian Federation: Baiting the Bear?

Noah Rubins* & Azizjon Nazarov**

I. Introduction***

In July 2004, the Russian oil giant Yukos was charged with tax code violations. The resulting court proceedings resulted in the imprisonment of Yukos' former chief, Mikhail Khodorkovsky, tax assessments of billions of dollars, and the liquidation of the company's assets. Many of Yukos' most important operating assets were acquired at auction by Russian state-owned companies. Whatever the merits of the tax investigation, the move against Yukos was widely viewed as politically motivated.[1] In response to these events, a Cypriot corporate shareholder of Yukos, known as Group Menatep, stated publicly that it would challenge the legality of the auction on an international level.[2] In 2005, Menatep filed a US$28 billion arbitration claim against the Russian Federation under the Energy Charter Treaty, a European multilateral agreement designed to protect and encourage investment in the energy sector. It was soon followed by other Yukos shareholders from around Europe.[3] What are these claims, and how did these investors gain access to an international forum for the resolution of their dispute with the Russian Federation government? And do they have any chance of success?

The answer to these questions begins in 1959, when West Germany and the Islamic Republic of Pakistan signed the very first modern treaty on the encouragement and mutual protection of investments.[4] Today, at least 2,400 such international agreements have been signed, spanning the entire world. While these treaties differ in a range of important

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[1] *Spanish financial investors initiate arbitration against Russia over Yukos*, IISD Investment Treaty News (ITN), 27 April 2007.
[2] Menatep's Yukos claim is largest in investment treaty history, others in offing?, IISD Investment Treaty News, 22 February 2005.
[3] *Yukos Universal Ltd. (UK – Isle of Man) v Russian Federation*; *Hulley Enterprises Ltd. (Cyprus) v Russian Federation*; *Veteran Petroleum Trust (Cyprus) v Russian Federation*.
[4] For more general information about investment treaties and recourse to international arbitration, see Noah Rubins & Stephan Kinsella, International Investment, Political Risk, and Dispute Resolution (2005), particularly chapters 6 and 7.

ways, nearly all modern bilateral investment treaties (BITs) share one characteristic that makes them an unusual tool in international law. They allow private individuals and companies from each of the contracting States, in certain circumstances, to submit international arbitration claims directly against the other contracting State, if investments within the territory of that state have been subjected to measures that contravene BIT standards of protection.[5] Most treaties offer investors a menu of arbitration options, most commonly the World Bank's International Centre for the Settlement of Investment Disputes ('ICSID'), the Stockholm Chamber of Commerce ('SCC'), or arbitration without any supervising institution, for example pursuant to the rules of the United Nations Commission on International Trade Law ('UNCITRAL').[6]

The rapid expansion of the global network of investment protection treaties was linked to the desire of developing countries to attract foreign capital, as well as the inadequacy of traditional international law mechanisms for controlling political risk through diplomatic espousal. While the first BITs were concluded between developing and capital-exporting countries, today developing and transition-economy countries frequently enter into BITs between themselves. Multilateral treaties, such as the Energy Charter Treaty, bind a variety of countries across the Eurasian landmass to observe obligations similar to those found in BITs.

Each investment treaty contains its own definition of 'investor' and 'investment', and a description of the actions that may not be taken by the host State in relation to foreign investors and their investments. Nearly all contain a prohibition on expropriation without adequate compensation, covering not only direct seizure or nationalization, but also indirect or 'creeping' expropriation that destroys investment value or impacts ownership rights through regulations or other means.[7] These treaties also normally require that host States accord 'fair and equitable treatment' to qualifying investors and investments, and to refrain from taking actions that would undermine the reasonable expectations that formed the basis for the decision to invest.[8] Another common clause

[5] The first BIT with a 'direct' arbitration clause benefiting private investors was signed in 1969 between France and Tunisia.

[6] The Russian Federation is not a signatory of the 1965 Washington Convention, which forms the legal framework for arbitration at ICSID. As a result, most Russian investment treaties provide only SCC and *ad hoc* (including UNCITRAL) arbitration options.

[7] *Metalclad v United Mexican States*, ICSID Case No. ARB(AF)/97/1 (awarding US$16.7 million to a US corporation under the North American Free Trade Agreement as compensation for Mexico's actions in relation to a waste disposal facility, which substantially impacted the value of the investment).

[8] *CMS v Argentina*, ICSID Case No. ARB/01/8 (awarding over US$130 million in compensation to a US corporation under the US-Argentina BIT as compensation for Argentina's dismantling of a regulatory regime that ensured gas transportation companies a tariff level providing a reasonable rate of return).

provides for 'full protection and security' of investments.[9] Finally, clauses establishing a right to both national treatment and most-favored-nation treatment prevent host States from discriminating against foreign investors on the basis of their nationality, either in favor of local businesses or in favor of investors from third countries.[10]

BITs and their multilateral cousins, such as the North American Free Trade Agreement and the Energy Charter Treaty, have become essential elements of investment planning and management in many parts of the world. The Argentine financial crisis of 2000-2002 gave rise to more than thirty international arbitration cases pursuant to BITs, in which foreign companies claimed that Argentina's response to the challenges of that time destroyed the regulatory regime that had formed the basis of their decision to invest there in the first place. Several of these claims have already been adjudicated, resulting in damages awards in the hundreds of millions of dollars. Why then has there been relatively little attention to investment protection instruments in the context of the Russian Federation, until the Yukos claims brought them to the attention of the world? With Russia pursuing a new nationalist economic policy, particularly in relation to energy resources, why have relatively few foreign investors sought remedies through international investment arbitration?

The answer is rather complex, and relates in part to the Russian Federation's investment treaty program and the agreements it has signed. In this article, we will provide an overview of international investment protection instruments, review some of the recent cases involving the Russian government, and try to draw some conclusions about the potential of these treaties as tools for the promotion of economic and legal stability in the former Soviet space.

II. Russia's Investment Treaty Program

The Soviet Union concluded its first BIT – with its northern neighbour, Finland – in 1989. As *perestroika* deepened, the Soviet government concluded several other bilateral treaties with OECD countries, including France, Germany, and Canada. Many of these early Soviet BITs were rather conservative in their grant of investor protections – hardly a surprising circumstance, given the novelty of foreign investment in the slowly liberalizing economy.

[9] *Asian Agricultural Products Ltd v Sri Lanka*, ICSID Case No. ARB/87/3 (awarding US$460,000 to a U.K. company under U.K.-Sri Lanka BIT as compensation for Sri Lanka's failure to protect a shrimp farm from local military units in search of Tamil rebels).

[10] *Marvin Roy Feldman Karpa v United Mexican States*, ICSID Case No. ARB(AF)/99/1 (awarding 10 million Mexican pesos to a U.S. national under the North American Free Trade Agreement as compensation for Mexico's failure to provide import tax rebates similar to those offered to Mexican businesses).

Most significantly, most of the Soviet BITs (like those concluded by other Socialist countries at the time) include an arbitration clause of limited scope, providing consent to resolve only disputes related to the 'amount or mode of payment of compensation for expropriation'. As a result, there was no possibility to arbitrate claims of discrimination, unfair treatment, or other measures that were not serious enough in their impact to constitute expropriation. Indeed, such narrow dispute resolution clauses could be viewed as preventing the arbitration even of disputes about whether expropriation had occurred. According to the position taken by the Russian Federation later in the course of litigation, such disputes had to be submitted to Russian courts in the first instance, and only once such a court confirmed that expropriation had occurred (a highly unlikely outcome by any objective assessment) could an international tribunal accept jurisdiction to assess the compensation due under the applicable investment treaty.

After the Soviet Union disintegrated at the end of 1991, Russia urgently sought to attract foreign capital to support its economic restructuring and recovery. Boris Yeltsin's government quickly adopted a new model BIT in 1992.[11] This template offered significant improvements *vis-à-vis* the Soviet model, and in particular provided qualifying investors with the right to arbitrate all disputes arising out of their investments and the rights granted under the treaty. As part of this same liberalization process, Russia applied for accession to the World Trade Organization in 1993.[12] In 1995, Russia signed the Energy Charter Treaty, which provided protections equivalent to those found in BITs to investors in the energy sector from all over the Eurasian landmass. By the time Vladimir Putin became President at the beginning of 2000, Russia had signed at least 45 BITs.[13]

The beginning of Putin's administration marked a cardinal change in Russian policy with respect to investment protection treaties. Most importantly, the rate at which new BITs were signed dropped sharply. Only three treaties with relatively insignificant trading partners – Jordan, Thailand and Armenia – were concluded after 1999. Just as disturbing, hardly any investment treaties were ratified by the Duma, an essential pre-requisite for any such instrument entering into force. The failure to ratify was particularly pronounced with respect to treaties representing potentially significant inward capital flows: the U.S.-Russian Federation BIT, for example, was signed in 1994 and has languished in Duma

[11] The first Russian Federation Model BIT was approved by the Resolution of the Government of Russian Federation on 11 June 1992.

[12] Also in 1993, the WTO established the Working Party on Russian accession WTO, available at http://www.wto.org/english/thewto_e/acc_e/a1_russie_e.htm.

[13] See http://icsid.worldbank.org/ICSID/FrontServlet. This data is based upon information provided to ICSID by governments, and may not be exhaustive.

committees ever since. Likewise, the Energy Charter Treaty (as noted above, signed in 1995) was never even submitted to the Duma for ratification.

Moreover, the Russian Federation substantially changed the treaty text to which it was prepared to accede. A new Model BIT was adopted by the government in 2001, with a range of important differences from the Yeltsin-era version.[14] In particular, some of the most fundamental substantive protections were excised from the 2001 model, including national treatment, most-favored-nation treatment, and fair and equitable treatment.[15] A subsequent legislative act appears to have re-inserted some of these protections,[16] but the Russian Federation-Armenia BIT of 2001 (as noted, one of only three treaties signed in the 2000s) followed the more limited model precisely.[17] Another significant aspect of the 2001 Model BIT can be found in its dispute resolution provisions. In accordance with Article 7(2), the 2001 model suggests that claims will be subject to arbitration only if all parties agree to this *after the dispute arises* – an unlikely outcome indeed.

Naturally, not all of Russia's treaties have been drafted in accordance with its model. As is the case with most such agreements, the text reflects a negotiation process and often results in a hybrid. But even where the 2001 model has not been applied, troubling limitations were nevertheless introduced. For example, the Russian Federation-Thailand BIT of 2002 limits the scope of protection to investments that have received specific government approvals in accordance with local law.[18] Such a requirement has been applied strictly by some arbitral tribunals, raising the possibility that formal defects in the approval documentation of an investment project could be invoked to prevent redress against later government interference.[19]

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[14] Decree No. 456 of the Government of the RF of 9 June 2001 'O tipovom soglashenii mezhdu pravitel'stvom RF i pravitel'stvami inostrannykh gosudarstv o pooshchrenii i vzaimnoj zaschite kapitalovlozhenij.' Some treaties had already begun to incorporate provisions similar to the Soviet model. See Lithuania-Russian Federation BIT (1999), Art. 10 (dispute resolution clause covering disputes related to investments, 'including' those concerning the mode or amount of compensation for expropriation).

[15] Mark Luz, 'New Model Bilateral Investment Treaty: A Step Backwards for Foreign Investors', *Russian/East European Business & Finance Report*, 15 October 2001.

[16] Decree No. 229 of the Government of the RF of 11 April 2002 'O vnesenii dopolnenij i izmenenij v tipovoe soglashenie mezhdu pravitel'stvom RF i pravitel'stvami inostrannykh gosudarstv o pooshchrenii i vzaimnoj zaschite kapitalovlozhenij.'

[17] Russian Federation-Armenia BIT (2001), Art. 2 (no fair and equitable treatment, most-favored-nation treatment, or national treatment provided).

[18] Russia-Thailand BIT (2002), Art. 2(3).

[19] *Philippe Gruslin v Malaysia*, ICSID Case No. ARB/, Award of 27 September 2000, para. 25.5 (rejecting jurisdiction over investments that did not constitute an 'approved project' in accordance with the Belgium-Malaysia BIT).

The Russian Federation was quick to justify the changes to its BIT practice. Somewhat strangely, certain government officials insisted that the shift in policy was largely due to Russia's likely accession to the WTO,[20] suggesting that the suspension of the treaty ratification process would somehow limit the Russian Federation's negotiations in relation to the multilateral trade body.[21] Ostensibly, the concern was apparently that any trade advantages granted by Russia to WTO members on entry into the organization would have to be granted to all of Russia's BIT partners by operation of the standard MFN clauses in investment treaties. This excuse is difficult to accept. Most of the BITs that Russia has ratified are with states already members of the WTO, and therefore Russia's entry into the organization would add little to the advantages BIT partners could hope to obtain. Furthermore, members of international trade organizations routinely avoid generalizing the effects of those arrangements by expressly limiting the effect of the MFN clauses in the investment treaties that they sign.[22]

Rising natural resource prices and the stabilization of the Russian economy after 2000 would appear to be a far more likely motivation for the changes in treaty policy. Russia's Deputy Minister of Economic Development and Trade admitted as much in 2001, stating that the freeze on new BITs was undertaken to avoid granting any 'new privileges' to foreign investors.[23] With no particular need to attract foreign capital, and still relatively limited outward investment on the part of Russian companies, the government could see no particular benefit to limiting its freedom to act in relation to foreign investors.

Whatever the motivation, the result is that the Russian Federation has placed its investment treaty negotiation and ratification program in stasis. The seizure of the assets of Yukos did nothing to inspire further movement within the Russian government with respect to investment protection treaties. In particular, the potential exposure of the Russian state to arbitration claims under the Energy Charter Treaty has relegated the ratification of that convention to permanent doldrums – even if the Russian government does not appear resolved to repudiate it outright.

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[20] *Russia likely to join WTO in Q3 2008*, RBC News, 19 December 2007, http://www.rbcnews.com/free/20071219125531.shtml

[21] *U investorov otnimaiut prava*, Vedomosti, 14 June 2001.

[22] See, eg, Belgium-Moldova BIT (2002), Art. 3(4) (protection against discrimination 'does not extend to privileges that a Contracting Party' extends to investors of a third State by virtue of its participation in or association with a free trade zone, a customs union, a common market or any other form of regional economic organization').

[23] *U investorov otnimaiut prava*, Vedomosti, 14 June 2001.

III. An Early Investor Victory: Sedelmayer v Russian Federation

The caution with which Russia has approached investment treaties and their ratification has not prevented some disgruntled investors from taking their grievances against the government to arbitration. In the wake of the Russian government bond default of 1998, at least one major investment bank initiated an expropriation claim against the Russian Federation pursuant to the United Kingdom-Russian Federation BIT, conducted under the UNCITRAL arbitration rules. This claim was settled before any decision was rendered by the tribunal.

The first modern investment treaty arbitration to arrive at a verdict against Russia was *Sedelmayer v Russian Federation*.[24] The claimant was Mr. Franz Sedelmayer, a German citizen and the sole owner of a business dedicated to the training and equipment of police and security personnel. In 1991, Sedelmayer's company entered into a joint venture with the Leningrad police department. As part of its contribution to the initial capital of the enterprise, the local police provided the use of buildings in a prestigious and peaceful section of the city. The enterprise began to work, but in late 1994 President Yeltsin ordered the joint venture's premises to be repossessed by the government.[25] Mr. Sedelmayer was forced to abandon the facilities and leave St. Petersburg on short notice, leaving vehicles and other personal effects behind.

In January 1995, Mr. Sedelmayer submitted a claim to *ad hoc* arbitration in Stockholm under the Germany-Russian Federation BIT of 1989. The German treaty was drafted in accordance with the Soviet model, with its characteristically narrow dispute resolution clause. However, it also included an additional Protocol, expanding the scope of arbitral jurisdiction to include disputes arising out of government interference that significantly reduced the value of investments.[26] As a result, Sedelmayer faced no strong jurisdictional challenge from the Russian side.[27] In mid-1998, the tribunal issued an award holding the Russian Federation liable for the seizure of Mr. Sedelmayer's property.[28] Russia was ordered to pay US$2.35 million plus interest as compensation for

[24] *Franz Sedelmayer v Russian Federation*, *ad hoc* Award of 7 July 1998.

[25] Sedelmayer's land and buildings on St. Petersburg's prestigious Kammenyj Ostrov were eventually converted into a guest residence for visiting foreign dignitaries, and continues to serve this purpose today.

[26] Germany-Russian Federation BIT (1989), Protocol, Art. 3.

[27] The Russian Federation raised six jurisdictional objections: that (1) Mr. Sedelmayer was not an 'investor' within the meaning of the BIT; (2) no 'investments' had been made; (3) no expropriation occurred; (4) *lis pendens* prevented adjudication of the dispute; (5) the Russian Federation was not a proper respondent; and (6) the claimant had not complied with pre-arbitration procedures stipulated in the BIT. *Sedelmayer*, at 48. All of these defenses were rejected.

[28] *Sedelmayer*, at 72-73.

his interest in the premises, personal effects and vehicles. The total amount due quickly mounted to nearly US$10 million.

It soon became clear that the Russian government was not about to honour the *Sedelmayer* award voluntarily.[29] Mr. Sedelmayer sought out Russian state-owned assets in a number of Western European countries, but faced initial difficulties overcoming local laws on sovereign immunity of assets.[30] After several years, however, Mr. Sedelmayer obtained a court order arresting an apartment complex in Cologne, Germany, owned by the KGB's successor organization, the FSB. He attached the income streams from the tenants to obtain full payment of the award, including interest.[31]

IV Current Issues in Investment Arbitration against the Russian Federation

Mr. Sedelmayer's quest for neutral, international adjudication of his investment dispute is not unique. As noted earlier, a number of claimants have initiated arbitration against the Russian Federation before and since, although none has yet resulted in a final monetary award. The cyclical pattern of Russia's investment treaty practice over the last two decades has left a wide variety of treaty texts in force today. A few of the treaties in force today are modern and textually harmonized with BITs in other parts of the world – Russia's treaties with Norway, Denmark, and Greece offer prominent examples.[32] Most of the treaties concluded with Russia's most important trading partners are less clear in their application, presenting difficult interpretative questions for many arbitral tribunals faced with treaty claims against the Russian Federation.

In particular, two issues that have arisen in investment treaty practice are particularly relevant in the context of Russia-related disputes: the expansion of arbitration through most-favoured-nation clauses, and the provisional application of unratified treaties – especially the Energy Charter Treaty. The eventual resolution of these two thorny problems in future arbitral decisions may pave the way for more reliable dispute settlement against the Russian Federation.

[29] Commentators believe that up to 90% of international arbitration awards are satisfied voluntarily, without any need for court intervention or seizure of assets. While the statistics may be somewhat less favourable with respect to awards rendered under bilateral and multilateral investment treaties, voluntary compliance is still relatively common in such cases.

[30] 'Jilted Yukos shareholders turn to Energy Charter Treaty arbitration', *Investment Treaty News*, 18 November 2004.

[31] David Crawford, 'Businessman vs. Kremlin: War of Attrition', *Wall Street Journal*, 6 March 2006.

[32] Norway-Russian Federation BIT (1995); Denmark-Russian Federation BIT (1993); Greece-Russian Federation BIT (1993).

As noted above, nearly all modern BITs include a provision guaranteeing qualified investors 'most-favored-nation' treatment. Other than some of the most recent examples (none of which have been ratified), Russian treaties are no exception. In accordance with such clauses, the host state is obligated to accord to investors of the other treaty party treatment no less favorable than that received by investors from third countries. In other words, based on an MFN clause, a qualifying investor can benefit from any rights enjoyed by third-country investors – including rights conferred in another treaty.

The variation in Russian BIT arbitration clauses has been described above. While many Russian treaties (particularly those signed in the Soviet period) include arbitration clauses limited in scope to the amount and mode of payment of compensation for expropriation, others provide for expansive arbitral jurisdiction. This situation raises the question whether an investor from the United Kingdom, who may not arbitrate disputes related to alleged expropriation or breaches of the 'fair and equitable treatment' standard, is treated less favorably than a Norwegian investor, who benefits from a treaty that allows him to do so.

Investment arbitration tribunals have failed to reach any clear decision about whether an MFN clause can be used to rectify this type of 'discrimination', importing more favorable dispute resolution provisions from other treaties signed by the host State. The tribunal in the *Maffezini v Spain* case concluded that the MFN clause covers procedural rights conferred by BIT dispute resolution provisions.[33] But another tribunal, in *Plama v Bulgaria*, ruled that arbitration clauses may only be expanded in this way if the MFN clause in question *expressly* provides for it (which is almost never the case).[34] Subsequent decisions have been divided, with proponents of both the more restrictive[35] and more expansive interpretation of MFN treatment.[36]

Two recent cases dealing with this issue involved the Russian Federation. In *Berschader v Russian Federation,* two Belgian investors won a public tender for the construction of a new Russian Supreme Court building in Moscow.[37] In September 2001, after work was nearly complete, Putin's office annulled the construction contract, and Ministry of Internal Affairs troops ejected Berschader's personnel from

[33] *Emilio Augustin Maffezini v Spain*, ICSID Case No. ARB/97/7.
[34] *Plama Consortium Ltd v Bulgaria*, ICSID Case No. ARB/03/24.
[35] *Siemens A.G. v Argentina*, ICSID Case No. ARB/02/8; *Gas Natural SDG S.A. v Argentina*, ICSID Case No. ARB/03/10.
[36] *Salini Construttori SpA & Italstrade SpA v Jordan*, ICSID Case No. ARB/02/13; *Telenor Mobile Communications S.A. v Hungary*, ICSID Case No. ARB/04/15.
[37] *Vladimir & Moise Berschader v Russian Federation*, SCC Case No. V(080/2004), Award of 21 April 2006.

the project site. Millions of dollars remained unpaid for work already done. In August 2004, the Berschaders filed a claim against Russia at the Stockholm Chamber of Commerce under the 1989 Belgium-USSR BIT, claiming compensation of US$13.3 million. The arbitration clause of the treaty established jurisdiction only with respect to disputes 'concerning the amount or mode of compensation to be paid under Article 5 [on expropriation] of the present Treaty.[38] The *Berschader* tribunal first concluded that this clause could only be invoked *after* a Russian court had issued a decision confirming the occurrence of expropriation.[39] Next, the tribunal reviewed the claimants' argument that the expansive dispute resolution clause of the Norway-Russian Federation BIT should apply instead, by operation of the MFN clause. While in principle the arbitrators agreed that MFN treatment could extend to procedural rights, but found that the particular terms of the Belgian treaty were insufficiently clear to allow the importation of the Norwegian arbitration clause. 'An MFN provision in a BIT will only incorporate by reference an arbitration clause from another BIT where the terms of the original BIT clearly and unambiguously so provide or where it can otherwise be clearly inferred that this was the intention of the Contracting Parties'.[40] The Tribunal rejected the Berschaders' claims for want of jurisdiction.

The picture was further muddied for potential claimants against the Russian Federation by the late 2007 jurisdictional decision in *RosInvestCo UK v Russian Federation*. RosInvest was the owner of US$7 million in ordinary shares of Yukos. After the Russian government charged Yukos with tax evasion in December 2004, RosInvest's Yukos shares lost nearly all of their value. In October 2005, the company submitted a claim to arbitration at the Stockholm Chamber of Commerce, pursuant to the United Kingdom-Russian Federation BIT. This treaty included an arbitration clause almost identical to the one at issue in *Berschader*, as well as a similar MFN clause. Like the *Berschader* tribunal, the arbitrators in *RosInvestCo* held that the expropriation claim could not be adjudicated directly under the UK treaty.[41] However, the claimant also argued that the broad dispute resolution provisions of the Denmark-Russian Federation BIT should apply by virtue of the MFN clause. The Tribunal focused on the wording of the treaty's MFN clause, which granted to UK investors all superior third-party rights related to the 'management, maintenance, use, enjoyment or disposal of their investments'. The arbitrators reasoned that the right to arbitrate investment disputes must be considered part of the 'use' and 'enjoyment' of the investments in

[38] Belgium-Russian Federation BIT (1989), Art. 10(1).
[39] *Berschader*, at para 155.
[40] *Berschader*, para. 181.
[41] *RosInvest Co. Ltd v Russian Federation*, SCC Case No. V(079/2005), Decision on Jurisdiction of October 2007, at para. 123.

dispute. The Tribunal therefore accepted jurisdiction over the claim of expropriation, as provided in the Denmark-Russian Federation BIT.[42]

A second fundamental interpretative question has arisen out of the Russian Federation's decision to stall or cancel the ratification process for a large number of investment protection treaties. There is relatively little debate about the general effect of treaties that have been signed but not ratified. The Vienna Convention on the Law of Treaties, which codifies the most fundamental rules of treaty interpretation and application according to customary international law, specifically provides that signatories must not take actions that would undermine the purpose of a treaty, pending ratification.[43] The corollary of this rule is that the obligations of a treaty do not take *full effect* until the treaty is ratified in accordance with the signatory state's internal constitutional requirements. The obligations in the interim are 'soft', exhortative, and without any effective means of enforcement.

While this general rule may apply to the many BITs that the Russian Federation has signed but never ratified, the situation could be different with respect to the Energy Charter Treaty.[44] This is because the ECT contains its own specific provision dealing with the treaty's effect between signature and ratification. Article 45 (1) of the ECT states that '[e]ach signatory agrees to *apply this Treaty provisionally* pending its entry into force ... to the extent that such provisional application is not inconsistent with its constitution, laws or regulations'.[45] The effect that this 'provisional application clause' should have upon the Russian Federation's ECT obligations has yet to be determined directly by an arbitral tribunal. On the one hand, if Article 45(1) is to have any effect at all, one would expect that it would impose greater obligations upon the signatory state than the 'soft law' rule of customary international law. Otherwise, why include such an unusual provision in the ECT? On the other hand, it is difficult to imagine that Article 45(1) requires the application of the treaty in full, as if it were already ratified. Such an approach would seem to make ratification by parliamentary vote superfluous, raising a serious concern of 'democratic deficit' and subversion of national constitution structures.

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[42] *RosInvestCo*, at para. 130. A similar result was reached in the recent UNCITRAL arbitration in *European Media Ventures, S.A. v Czech Republic,* Decision on Jurisdiction of 15 May 2007. The facts of the case were described in English High Court decision that resulted from the Respondent's attempt to set aside the award. *Czech Republic v European Media Ventures, S.A.,* High Court Decision of October 2007, para. 130.

[43] Vienna Convention on the Law of Treaties (1969), Art. 18.

[44] Ulrich Klaus, 'Gate to Arbitration: The Yukos Case and the Provisional Application of the Energy Charter Treaty to the Russian Federation', 2:3 *Transnational Dispute Management* (2005).

[45] Energy Charter Treaty, Art. 45(1), untreaty.un.org/unts/144078_158780/10/8/3517.pdf.

The tribunal in *Petrobart v Kyrgyzstan* dealt with this difficult question in passing.[46] The Claimant in the case was a company created under the laws of Gibraltar, which initiated SCC arbitration against Kyrgyzstan under the ECT in relation to gas supplies in Central Asia. When the United Kingdom signed the ECT, it expressly included Gibraltar as one of the territories to which the treaty would apply (along with the Channel Islands and other British offshore possessions). However, when the UK *ratified* the ECT some months later, the ratification instrument did not include Gibraltar as a covered territory. As a result, Petrobart was a qualifying UK 'investor' only if the United Kingdom's *signature* gave effect to the ECT, rather than its *ratification*. The Tribunal held that Article 45(1) of the ECT meant that the signature document, with its reference to Gibraltar, was already sufficient for the treaty to enter into effect with respect to the United Kingdom, and that this accession remained in force indefinitely.[47]

The implication of the *Petrobart* decision is that the Russian Federation will be subject to investment arbitration under the Energy Charter Treaty even though it has not ratified it. The *Plama* tribunal seemed to have no difficulty with that concept either, declaring in passing (and without any particular need to do so) that 'Article 45(1) ECT provides that each signatory agrees to apply the treaty provisionally pending its entry into force for such signatory … it follows that Article 26 [on arbitration] provisionally applied from the date of a state's signature …'.[48] A similar conclusion was reached in the *Kardasspoulos v Georgia* arbitration, where expropriatory acts had allegedly occurred between the signing and entry into force of the ECT for Georgia and Greece.[49] The debate continues unabated, however, with the issue of provisional application scheduled to be decided soon in relation to the Yukos-related arbitrations. In particular, a central question will be whether provisional application of the ECT as a whole would be contrary to Russian law, blocking the application of Article 45 according to its terms.[50]

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[46] *Petrobart v Kyrgyzstan*, SCC Case No. V(126/2003), Award of 29 March 2005.

[47] For a critique of the *Petrobart* tribunal's reasoning, see Georgios Petrochilos & Noah Rubins, 'Observations on Petrobart v Kyrgyzstan', 2005(3) *Stockholm International Arbitration Review* 100.

[48] *Plama v Bulgaria*, at para 140.

[49] *Kardassopoulos v Georgia*, ICSID Case No. ARB/05/18, Decision on Jurisdiction of 6 July 2007. The provisional application of the ECT in this case was not entirely necessary to the upholding of jurisdiction, since the claimants had initiated arbitration under two treaties: the ECT and the Greece-Georgia BIT.

[50] For further discussion, see A Hutcheon and J Spencer, 'Provisional Application of the Energy Charter Treaty, 2008 *The European and Middle Eastern Arbitration Review* 25.

V. Conclusion

Time will tell whether these and other controversial legal issues will be resolved in favour of claimant investors or the Russian government. It is already certain that the arbitration claims submitted by Menatep and the other Yukos shareholders will prevent the ratification by the Russian Duma of the Energy Charter Treaty (as well as a dozen or so BITs) in the foreseeable future.

It is very unlikely that even total victory in arbitration against the Russian Federation will lead directly to monetary compensation for aggrieved investors. The enforcement of arbitral awards in Russia has long presented serious problems for foreign contracting parties. The Russian courts' consistent application of international conventions on the enforcement of foreign commercial arbitration awards does appear to be improving in recent years.[51] However, there is little sign that the Russian government has changed its recalcitrance with respect to arbitration awards rendered against it. The Russian government has often taken advantage of the inability of foreign creditors to enforce against state assets in Russia, combined with sovereign immunity rules in other countries, to delay payment of awards for years. Only dogged persistence and skilled investigators and lawyers have managed to locate and attach Russian government assets abroad – as in the *Sedelmayer* case, described above. In other instances, payment may be even longer in coming.[52]

Nevertheless, the existing Russian investment treaty regime may provide a realistic avenue to limit or rectify unfair and unexpected government interference in commercial affairs. Russia has signed and ratified more than 30 BITs, of which at least half were drafted according to a more or less standard OECD template. Already, many foreign investors in Russia are structuring their investments not only to minimize tax burdens and to access advantageous regulatory regimes, but also to benefit from investment treaty protection. Carefully examining the provisions of investment treaties in force and considering incorporation of project vehicles in appropriate jurisdictions has become an essential part of business planning.

[51] K Hober, *Enforcing Foreign Arbitral Awards against Russian Entities* (1999); V Khvalei, 'Recognition and Enforcement of Foreign Arbitral Awards in the Russian Federation' 2005(1) *Stockholm International Arbitration Review*.

[52] 'Noga Takes the Final Step', *Kommersant*, 15 January 2008 (more than a decade after receiving a US$800 million SCC arbitration award against the Russian Federation, the Swiss company Noga continued to search for and attach Russian sovereign assets, battling European sovereign immunity rules all the way); 'Noga Takes Off', *Kommersant*, 18 January 2008 (Noga succeeded in freezing hundreds of millions of dollars in EADS stock held by a Russian state-owned bank, and appeared finally to be near the end of its saga).

For now, the Russian Federation has been relatively immune from the effects of the investment protection treaties it has signed. But increasing knowledge about the function of these instruments among the foreign investment community has already led to an increasing number of arbitration claims against the government. It is still unclear whether most of these claims will result in enforceable judgments, or influence Russia's policy towards foreign capital. At the very least, these new actions may provide a new way to procure a seat at the negotiating table with a government otherwise disinclined to compromise.

Moral Damages in International Investment Law: Some Preliminary Thoughts in the Aftermath of *Desert Line v Yemen*

Borzu Sabahi*

I have written this piece as a tribute to Thomas W. Wälde's memory. He was a leading figure in the college of international lawyers, a dear friend, and a mentor to me. Thomas' death was untimely; but he lived a full life. He had varied interests and I was only familiar with one of his specialties, which was investment treaty arbitration. It was in 2003 when I first contacted him to join the OGEMID listserv. As was his style, he quickly replied and signed me up. Later, I got to know him better when I worked under his supervision at The Hague Academy's Centre for Studies. Since then, we collaborated on a number of projects and academic papers. He was incredibly resourceful and enthusiastic about ideas and people. It was both fun and challenging to work with him. Among many other things, he suggested the topic of my doctoral dissertation (damages in international investment law) and later invited me to work with him on a report on the international law of damages.[1] Thomas was an inspiration and remains one. His legacy for the investment arbitration community is perpetuated through OGEMID listserv, TDM, and his numerous writings, which will nurture the thinking of the interested community in the years to come.

I. Introduction

Awarding compensation for moral damages has a long pedigree in public international law. One of the oldest cases cited for recoverability of compensation for such damages is the *Lusitania* case.[2] This case arose out of the sinking of Lusitania, a British liner carrying passengers between New York and Liverpool, by a German submarine during

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[1] TW Wälde & B Sabahi, 'Compensation, Damages, and Valuation' in P Muchlinski, F Ortino and C Schreuer (eds.) *The Oxford Handbook of International Investment Law* 1049.

[2] See, eg, *Lusitania Cases,* Opinion, 7 RIAA 32 (1923).

World War I.[3] Umpire Parker in that case held that the aggrieved party, under international law, could be compensated for: 'an injury inflicted resulting in mental suffering, injury to his feelings, humiliation, shame, degradation, loss of social position or injury to his credit or to his reputation…'.[4]

The duty to repair moral damages arises from the general reparation obligation in international, which, as the *Chorzów Factory* case[5] states, requires putting the victim of an internationally wrongful act in the same economic position that he would have possessed, if the unlawful act had not occurred ('hypothetical position').[6] The International Law Commission Articles on Responsibility of States for Internationally Wrongful Acts ('ILC Articles')[7] further clarify that reparation due for the commission of a wrongful act must eliminate all injury caused thereby, whether material or moral.[8]

In investment arbitration, the issue of moral damages recently arose in the ICSID case of *Desert Line v Yemen*,[9] which revived interest in this topic. The *Desert Line* case arose out of Yemen's failure to abide by a domestic arbitration award between Desert Line Co., an Omani company, and the Government of Yemen, which required Yemen to pay damages to Desert Line under several road construction contracts. As a result, Desert Line in 2005 commenced ICSID arbitration against Yemen under Yemen-Oman BIT. The ICSID tribunal held that the Yemen's failure, as well as its other acts, violated fair and equitable treatment provision of the BIT and ordered Yemen to pay to Desert Line the amount of the domestic

[3] Unknown by the passengers, the ship was loaded with contraband ammunition bound for England to assist the latter in her war efforts against Germany. The Germans had learned about this. See T A Bailey, 'The Sinking of the Lusitania', 41 AM. *Historical Rev* 54, 61-62(1935).

[4] *Lusitania*, *supra* note 2, at 40.

[5] *The Factory at Chorzów* (*Germany V Poland*), Decision on Indemnity, 1928 PCIJ (Ser. A) No. 17.

[6] ibid, at 47.

[7] See J. Crawford, The International Law Commission's Articles On State Responsibility: Introduction, Text And Commentary 77 et seq (Cambridge University Press 2002).

[8] ILC Article 31 provides that: '1. The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act. 2. Injury includes any damage, whether material or moral, caused by the internationally wrongful act of a State'.

[9] *Desert Line Projects LLC v Yemen*, Award, ICSID Case No ARB05/17; IIC 319, ¶¶ 284 *et seq* (2008). The last time that such compensation for moral damages was awarded was in the early ICSID case of *Benvenuti & Bonfant v Congo. S.A.R.L. Benvenuti & Bonfant v People's Republic of the Congo*, Award, ICSID Case No. ARB/77/2; 21 ILM 740 (1982). Other claimants in investment treaty cases that have unsuccessfully sought compensation for moral damages are *Bogdanov and ors v Moldova*, Award, Ad hoc—SCC Arbitration Rules; IIC 33 (2005), 87 (compensation for moral damages was denied, because claimant failed to produce any factual evidence for moral damages); and *Helnan International Hotels AS v Egypt*, Award, ICSID Case No ARB/05/19; IIC 340 (2008) (claims dismissed).

arbitration award plus interest. In addition, the tribunal ordered Yemen to pay US$1,000,000 as compensation for moral damages.[10]

In regard to moral damages, several parts of the tribunal's rulings merit attention. The tribunal, for example, noted that Yemen had harassed the claimant's executives, threatened and detained them, and also had not prevented certain armed tribes from harassing the claimant's employees. As a result, the claimant had suffered a significant injury to its credit and reputation and lost its prestige.[11] These acts, particularly 'the physical duress exerted on the executives' were malicious and a basis for a fault–based liability, which entitled the claimant to the recovery, among others, of compensation for moral harms.[12] The tribunal, however, did not award interest on the compensation for moral damage, because 'this amount is at the entire discretion of the Arbitral Tribunal'.[13]

In light of this case, this paper examines: types of moral damage (Section 2); relation of moral damage to material damage and the risk of double-counting (Section 3); jurisdiction of arbitral tribunal and moral damages (Section 4); corporations and recovery of compensation for moral damages (Section 5); fault and exceptional circumstances (Section 6); quantifying moral damages (Section 7); compensating legal damages (Section 8); interest on compensation for moral damages (Section 9); and Section 10 is the conclusion.

II. Types of Moral Damage

The term 'moral' damage in public international law is used to refer to those categories of harms that are non-material or non-financial. Three types of non-material harms may be distinguished:

1) Damage to personality rights of individuals. These include 'individual pain and suffering, loss of loved ones, or personal affront associated with an intrusion on one's home or private life'.[14] This is the typical type of non-material damage that natural persons suffer. Corporations, as juridical persons, cannot suffer such damages.[15]
2) Damage to reputation. This type of damage seems to have a dual character, as it may have clear monetary consequences and hence in some cases be considered as material.[16]

[10] *Desert Line*, *supra* note 9, ¶ 291.
[11] ibid, at ¶ 286.
[12] ibid, at ¶ 290.
[13] ibid, at ¶ 297.
[14] Commentary 5 on ILC Article 31. Crawford, supra note 7, at 202, comm. (5).
[15] See, e.g., the Supreme Court of Philippines' decision in *Mambukto Lumber Co. vs. PNB* (L-22973, January 30, 1968).
[16] See the discussion in the next Section.

3) 'Legal damage'. That is the harm that results from the *ipso facto* violation of an international obligation.[17]

III. Relation of Moral Damage to Material Damage and Risk of Double Counting

There is some overlap between harms that fall under the term 'moral damage' and those that may be characterized as material or physical damage. For example, damage to reputation (particularly to that of a corporation) could have serious monetary consequences. Or mental suffering caused to a person could decrease his productivity and result in pecuniary losses. This overlap, hence, calls for a cautious approach to awarding compensation for moral harms. The main risk to be avoided is double-counting, in case such harms have been already compensated as a material damage.[18]

Risk of double-counting is particularly acute when Fair Market Value ('FMV') of a business is awarded. Among various components of FMV is good will, which includes the value of the business' reputation.[19] If a tribunal, in addition to the FMV, awards compensation for moral damage to reputation, that would constitute double-counting.[20]

When an arbitral tribunal awards sunk investment costs[21] or business interruption losses, or uses other valuation methods, which do not take into account the good will or more specifically, damage to reputation, then the recovery of moral damage to reputation would be justified.[22] Given the dearth of cases where moral damages have been sought and awarded, two hypotheticals based on cases decided in the past illustrates the issue. In *LG & E v Argentina*,[23] the tribunal effectively awarded compensation for business interruption by giving the claimants the value of the dividends that they could have received had Argentina not changed the regulatory framework of gas transmission business. The claimant, subject to proof, could have conceivably sought

[17] Brownlie refers to it as 'injury'. Ian Brownlie, *System of the Law of Nations: State Responsibility* (Oxford 1983)(hereinafter 'System') 199.

[18] On the differentiation between the two see Jennifer Cabrera, Moral Damages in Investment Arbitration and Public International Law, Draft Paper presented in the Third Annual Juris Conference, Washington, DC, April 2009 (hereinafter '2009 Juris Conference'), on file with the author, at p 7.

[19] International Valuation Standards Committee ('IVSC'), International Valuation Standards (8th ed. IVSC 2007).

[20] Mark Kantor's remarks in the 2009 Juris Conference panel discussion on "Interpretation and Remedies in International Investment Arbitration. Should Moral Damages Be Compensable in Investment Arbitration?."

[21] M Kantor, *Valuation For Arbitration: Compensation Standards, Valuation Methods And Expert Evidence* (Kluwer Law International, 2008) 49 et seq.

[22] Kantor, panel discussion, *supra* note 20.

[23] *LG&E Energy Corp and ors v Argentina*, Award, ICSID Case No ARB/02/1, IIC 295 (2007).

recovery for damage to its reputation and the tribunal could award such compensation. In *CME v Czech Republic*,[24] however, where claimant's received FMV of their business, the recovery of compensation for damage to the claimant's reputation would not have been possible. In *Desert Line*, considering that the main part of the award did not include the FMV of the claimant's losses; rather it gave what was due the claimant under the domestic arbitration award, recovery of compensation for moral damages was justified.

IV. Jurisdiction and Compensation for Moral Damages

Investment treaties generally do not seem to limit a tribunal's powers in this respect. Investment treaty tribunals, as long as they have jurisdiction over a dispute, may award compensation for moral harm caused to the investor or investment, unless there is a limitation on awarding compensation in such cases in the applicable treaty.[25] Investment treaties generally do not contain any limitation in this respect.[26] It follows that the international law rules on State responsibility and reparation govern and such harms must be repaired.

In this context, however, the correct characterization of the *remedy* sought is very important. In *Biloune v Ghana*,[27] for example, government demolished Mr. Biloune's hotel enterprise in Ghana. Further, it arrested and detained him for thirteen days without charge, and finally deported him to Togo. Mr. Biloune brought arbitration against Ghana based on a contract and Ghana Investment Code. Pursuant to the contract, the dispute was subject to the Ghanaian laws. He alleged that Ghana's actions constituted expropriation in contravention of the contract and Ghana Investment Code. Apart from seeking the value of its lost investment, Mr. Biloune sought recovery for violation of his human rights caused by his arrest and detention.[28]

The tribunal dismissed the latter part of the claims, on the ground that it lacked jurisdiction to hear issues related to violation of human rights.[29]

[24] *CME Czech Republic BV v Czech Republic*, Final Award and Separate Opinion, Ad hoc—UNCITRAL Arbitration Rules, IIC 62 (2003).

[25] The determination of the consequences of the violation, hence, is generally subject to the customary international law on State Responsibility, which in turn allows recovery of compensation for moral harms. *Siemens AG v Argentina*, Award and Separate Opinion, ICSID Case No ARB/02/8, IIC 227, 349 (2007); *Compañía de Aguas del Aconquija SA and Vivendi Universal SA v Argentina*, Award, ICSID Case No ARB/97/3, IIC 307 8.2.3- 8.2.7 (2007) (*hereafter Vivendi*).

[26] Some treaties, such as NAFTA, however, expressly prohibit awarding of punitive damages. See NAFTA Art. 1135(3).

[27] *Biloune & Marine Drive Complex Ltd. v Ghana InV Ctr.*, 95 ILR 183 (1993).

[28] ibid, at 203.

[29] ibid, at 202-3.

The tribunal, however, accepted its jurisdiction over the investment claims, and eventually held that Ghana had unlawfully expropriated Mr. Biloune's property.[30] Insofar as the compensation for expropriation is concerned, the tribunal applied customary international law, and held among others that such compensation must put the claimant in the hypothetical position.[31] This statement echoes the language of the *Chorzów Factory* case and the ILC Articles. It allows the tribunal to award compensation for moral damages. The problem, however, possibly was that the claimant rather than asking for compensation for moral damages as a remedy, had opted to characterize it as an issue of human rights, which in turn would have required the tribunal to rule on the liability of Ghana for violation of such rights, rather than allowing the tribunal to consider it as a consequence of an unlawful act.

The treatment that Mr. Biloune received in that case does not seem to be much different from that which the Desert Line's executives received, both cases involved unwarranted arrest and detention and a variety of harassment tactics. Yet, he received zero compensation for the losses, and Desert Line received US$1,000,000. Characterization of the issue, thus, is important.[32]

V. Can Corporations Seek Compensation for Moral Damage to the Personality Rights of Their Employees?

Brining a claim requires having standing under the applicable investment treaty. Individuals under the great majority of investment treaties may bring a claim for violation of the treaty and seek compensation for damage to their personality rights as well as to their reputation. In modern practice of investment arbitration, however, corporations are the main users of the dispute settlement mechanisms of investment treaties. As noted, however, corporations cannot suffer damage to their personality rights. But, can corporations seek compensation for moral damage to the personality rights of their employees? The *Desert Line* case seems to answer this question in the affirmative. As noted, the claimant company in that case was awarded a lump sum for moral damages, which seemed to have predominantly been awarded for the harassment of the claimant's executives, duress and stress caused upon them, and their detention (as well as for the damage to the claimant's reputation).[33]

[30] ibid, at 210.

[31] ibid, at 228.

[32] For a different approach see Wade M. Coriell and Silvia Marchili, Unexceptional Circumstances: Moral Damages in International Investment Law, Draft Paper presented in the 2009 Juris Conference, on file with the author (they emphasize on the lack of causation in this case).

[33] The lead counsel for claimant, Hamid Gharavi, in a panel discussion in 2009 Juris Conference, noted that the case had tremendously affected the owner of Desert Line and the *Cont.*

A strict application of the rules on standing should prevent awarding compensation for damage to the executives' personality rights in the latter scenario. Yet, such an approach could cause practical problems, such as leaving these harms unrepaired, as the most relevant forum for bringing such a suit would be Yemeni courts,[34] which, among other things, may not be able to handle the case with the desired level of independence.

To remedy this legal shortcoming, then, it is submitted that, by analogy to the doctrine of State espousal, which revolves around the Vattelian fiction that injury to an individual is equal to the injury to the home State of individual,[35] one could think of a doctrine of 'corporate espousal', whereby damage to an employee of a corporation would be considered as damage to the corporation itself.[36] This is the assumption underlying the *Desert Line* case, and would solve the problem of standing.

VI. Fault and Exceptional Circumstances

Fault may take a variety of forms; including malicious and intentional infliction of injury as well as injury caused due to negligence, i.e., a failure to take the necessary level of care in a specific situation.[37] Fault in the modern doctrine of State responsibility is relevant only when the applicable primary rules of international law give it a role.[38]

In *Desert Line*, as noted earlier, the tribunal stated that Yemen had acted maliciously and its liability was fault-based,[39] which opened the door for the tribunal to compensate *Desert Line*'s moral damages. Further, the tribunal stated that compensation for moral damages is only available in 'exceptional circumstances', which seemed to imply that fault is a necessary condition for awarding such compensation.

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claim for moral damages was partly meant to remedy the owner's grievances. So another permutation of the issue would be whether the company can recover compensation for damage to the personality rights of its owner, who similar to his employees in this case, may not have standing.

[34] See S Ripinsky & K Williams, *Damages in International Investment Law* (BIICL 2008) 307 et seq.

[35] Emmerich de Vattel, 1 *Le Droit des Gens ou principes de loi naturelle* 136 (Carnegie Institution, Washington, DC 1916) (1758).

[36] Panel discussion in 2009 Juris Conference, supra note 20.

[37] See Brownlie, System, supra note 17, at 44 et seq.

[38] A fault-based provision is, for example, Article 1 of the Rome Convention on Damage Caused by Foreign Aircraft to Third Parties on the Surface, 1952, which provides that: 'Any person who suffers damage on the surface shall, *upon proof only* that the damage was caused by an aircraft in flight or by any person or thing falling therefrom, be entitled to compensation as provided by this Convention' (emphasis added) For other examples, see L. Oppenheim, International Law: A Treatise 510-11 (Longmans, Green & Co. 1905).

[39] *Desert Line*, supra note 9, at ¶ 290.

While various publicists have stated that fault or degrees of fault have an impact on the reparation due for committing an unlawful act,[40] rarely they deem fault as a necessary condition for awarding moral damages.[41] The jurisprudence is hardly helpful at coming up with a precise method to measure the monetary value or impact of fault on the amount of compensation.[42] Fault, however, seems to play the role of a gatekeeper, which, when present, permits the arbitrators to become more generous in awarding a higher amount of compensation in general and that for moral damages in particular. In the *Fabiani* case, for example, the moral damages awarded was 1/3 of the principal claim, which compared to *Desert Line*, 1/100 of the claim, was significantly higher.[43]

Insofar as exceptional circumstances in *Desert Line* are concerned, it seems that these circumstances are not part of the applicable legal standard and simply describe the gravity of the situation at hand.[44] The seeming importation of exceptional circumstances into the legal standard could be accidental and the result of the arbitral tribunal's reliance on human rights jurisprudence, in which the great majority

[40] Oppenheim, for example, states that '[a]part from the question of responsibility, the degree of fault attributable to the state may affect the nature and amount of reparation to be made'. Oppenheim, supra note 16, at 509; see also Gaetano Arangio-Ruiz, 'Second Report on State Responsibility', UN Doc. A/CN.4/425 & Corr.1 and Add.1 & Corr.1, 2(1) *YB Int'l L Comm'n* 1, 53 (1989) [hereinafter Arangio-Ruiz, *1989*]; Brownlie, System, *supra* note 17, at 46. The ILC Articles, however, do not contain any reference to the effect of fault on reparation for committing wrongful acts. They only refer to the concept of contributory fault (of the winning State) and its impact on the amount of compensation otherwise due it. *See* ILC Articles, *supra* note 7, at art. 39 and the associated commentary. Similarly, international tribunals occasionally have considered fault as an element that could augment the amount of compensation. See Brownlie, System, supra note 17, at 46 n.66 (*citing* 4 UNRIAA 82 (1925); *Baldwin* case (1842), in J Moore, 4 *History and Digest of the International Arbitrations to which the United States Has Been a Party* 3235 (1995); and *Rau Case*, *in* Marjorie Whiteman, 1 *Damages in International Law* 26 (1937). Insofar as moral damages in domestic law are concerned, malice could aggravate the amount of damages due, because it has most probably aggravated the claimant's suffering and humiliation. Pierre-Dominique Ollier & Jean-Pierre Le Gall, 'Various Damages' in *International Encyclopedia of Comparative Law, Torts* (A. Tunc, ed., Tübingen: J.C.B. Mohr, 1971), Vol. XI, Part 2, at 10-85.

[41] Admittedly, measuring the effects of a subjective element, such as 'fault', on the amount of compensation is difficult, if not impossible. That is why perhaps Arangio-Ruiz notes that international judges rarely have explicitly considered the pecuniary impact of fault in their judgments. He continues that the 'quantum of reparation … seems to be determined solely on the basis of the nature and extent of the damage caused, the absence, presence or degree of fault being for that purpose not relevant'. Arangio-Ruiz, *1989, supra* note 40, at 183.

[42] See, eg, *Fabiani* case (Fr. V Venez.), in G F de Martens, 27 *Nouveau recueil général de traités et autres actes relatifs aux rapports de droit international* 699 (2nd series, Leipzig 1902); and *Dix* case (U.S.-Venez. Mixed Claims Commission), 9 U.N.R.I.A.A. 119 (1902).

[43] *Fabiani*, supra note 42, at 699.

[44] Comments of Hamid Gharavi in the panel discussion at the 2009 Juris Conference, supra note 20.

of the cases, as a matter of course, involve individuals who have been exceptionally badly treated.[45]

VII. Quantifying Moral Damages

Moral damages, as noted, must be treated and repaired as any other head of damage in international investment law. Measuring such losses, however, is difficult and uncertain, because they are mainly intangible.[46] These concerns, however, have not stopped arbitral tribunals from awarding compensation for moral harms. Umpire Parker in *Lusitania*, held that the impossibility of computing damages with precision in such cases 'furnishes no reason why the wrongdoer should escape repairing his wrong or why he who has suffered should not receive reparation therefor measured by rules as nearly *approximating accuracy as human ingenuity can devise*'.[47]

Following this principle, in conjunction with the objective of reparation set forth in the *Chorzów Factory* case, which requires putting the victim of an unlawful act in the hypothetical position, one could conceive various methods of assessing such losses. Unfortunately, the investment treaty case law on the topic is still underdeveloped. In the absence of an established case law and guidance in investment treaties, looking into other relevant sources seems a good option. A prime candidate seems to be international human rights law. In the wake of the *Desert Line*, there are some suggestions that such law could provide guidance.[48] In fact human rights law contains a rich jurisprudence on the damage to personality rights of individuals.[49] Compensation awards in such cases, however, are relatively modest.[50] Some modern writers, hence, have criticized the applicability of human rights jurisprudence in international investment law.[51] Wade Corriel and Silvia Marchili, for example, observe that:

> [H]uman rights tribunals, because of the nature and purposes of the human rights treaties that they interpret, focus primarily on condemning

[45] Coriell et al, supra note 32.

[46] This uncertainty, however, is not unique to assessing compensation for moral damage; similar concerns exist in awarding lost profits or awarding compensation based on the forward looking valuation methods such as DCF.

[47] *Lusitania*, supra note 2, at 36 (emphasis added).

[48] See, eg, N Birch, 'A Moral Dilemma: Applying Moral Damages Principles from International Human Rights to Investor-State Arbitration', draft paper, 2009, on file with the author.

[49] See generally D Shelton, *Remedies in International Human Rights Law* (Oxford University Press 2005).

[50] See ibid. See also Ripinsky & Williams, supra note 34 ('…the two available investment treaty cases … Desert Line 1 % and B&B 2%').

[51] Paulsson cautions that it should be used with caution, because the purpose of human rights instruments are different from investment treaties. J. Paulsson, *Denial of Justice in International Law* (Cambridge University Press, 2005) 9.

> rather than compensating for human rights violations. Hence … most tribunals that have awarded them have only been secondarily concerned with compensation issue. Those tribunals have been primarily concerned with identifying and condemning human rights violations as serious breaches of international law. [52]

They conclude that this leads to a lower amount of compensation. This conclusion echoes the concern of the claimant's counsel in *Desert Line*,[53] who thought the amount of moral damages awarded was inadequate. He expected the tribunal follow *Fabiani*'s generous approach.[54]

Other sources that could be consulted include domestic law systems. Particularly civil law systems that seem to contain the origins of the concept of moral damages in modern international law.[55] Jennifer Cabrera suggests exploring the Law and Economics approach developed in the United States, which 'has advocated that judges do precisely what was found mathematically 'impossible' in Lusitania-assign economic values to rights and weight their relative merits thereby'.[56] Remediation process used in environmental law may be appropriate too.[57] Ultimately, with the accumulation of cases, benchmarking may make the process of quantifying moral damages easier.[58]

VIII. Compensating Legal Damages

Dionisio Anzilotti was one of the first scholars to support the idea that violation of a rule of international law, *ipso facto*, causes damage.[59] This line of reasoning has been subsequently followed by a number of publicists.[60] The ILC Articles seem to adhere to this principle when

[52] Coriell et al, supra note 32, at 7.
[53] Hamid Gharavi, comments on the panel discussion, supra note 33.
[54] See text accompanying footnote marker 43 supra.
[55] Cabrera, supra note 18, at 6.
[56] ibid at 6.
[57] Remarks of the panelists in the panel discussion at 2009 Juris Conference, supra note 20.
[58] Mark Kantor's remarks in the 2009 Juris Conference, supra note 20.
[59] D. Anzilotti, 'La responsabilité internationale des Etats à raison des dommages soufferts par des étrangers' (1906) 13 *RGDIP* 5; see also Arangio-Ruiz, 1989, supra note 40, at 6.
[60] See P Reuter, 'Le dommage comme condition de la responsabilité internationale' II *Estudios de Derecho Internacional: Homenaje al Profesor Miaja de la Muela* (Madrid, Tecnos, 1979) 844; Arangio-Ruiz, 1989, supra note 40, at 6 ((citing *Carthage and Manouba* cases, decisions of 6 May 1913 (*France v Italy*), 11 RIAA 449 et seq. & 463 et seq. respectively; *Corfu Channel* Case (*UK v Albania*) Assessment of the Amount of Compensation Due from the People's Republic of Albania to United Kingdom, 1949 ICJ Reports 4; *Rainbow Warrior Case*, (N.Z. V Fr.), 82 *I.L.R.* 499 (1990)); see also Brownlie, System, supra note 17, at 31-32, 236-38; C Gray, *Judicial Remedies in International Law* (Clarendon Press, Oxford 1990) 85; L Oppenheim, 1 *International Law* 528 (Jennings & Watts, eds., 9th ed. 1992); S Wittich, 'Non-Material Damage and Monetary Reparation in International Law' (2004) 15 *Finnish Y.B.I.L.* 321, 337; ILC Articles, supra note 14, art 31(2).

they consider a State internationally responsible, notwithstanding the absence of any material damage.[61]

Applying this doctrine in the area of investment treaty arbitration, the violation of an investment treaty certainly causes some sort of legal harm by disturbing the operation of the governing legal regime, which was set up to benefit foreign investors and their investments. But, does this entitle the aggrieved investor to reparation? As a rule, once State responsibility is established, the duty to provide reparation arises. Yet, the claimant has to put a monetary value on its losses in order to recover compensation.[62]

The implications of this approach are particularly important for cases where arbitral tribunals find a breach but not any material damage. This was the case in *Lauder*[63] and *Biwater*.[64] In those two cases, however, while the tribunals held the governments responsible, they refused to award compensation, because they found no causal relationship between the harms suffered by the investors and the actions of the respective governments. The hypothetical question is whether and how the tribunals could award any monetary compensation for the *ipso facto* violation of investment treaties or customary international law. Given the high risk of double-counting in such cases, arbitral tribunals should carefully consider awarding compensation for such a damage. At a minimum, perhaps complete shifting of the costs of arbitration, including the claimant's attorney's fees, should be permitted in such situations. Gary Born, in his partial dissenting opinion in *Biwater* supports this view. There are also cases where a non-monetary remedy seems to be appropriate, such as various modes of satisfaction,[65] and yet arbitral tribunals have converted that into money and awarded a so-called monetary compensation as *satisfaction*.[66] The danger for the arbitrators awarding compensation for such harms is the possibility

[61] ILC Articles, supra note 24, art 31(2)(subject to one exception: if the applicable primary rule makes material damage a pre-condition of State Responsibility). See also A Tanzi, 'Is Damage a Distinct Condition for the Existence of an Internationally Wrongful Act?', in M Spinedi & B Simma (eds), *United Nations Codification of State Responsibility* (Oceana, 1987) 1.

[62] In many domestic legal systems, breach of legal right creates liability, but in order to have a successful claim to recover compensation for such damages the victim must prove some sort of material/financial loss or pain and suffering. C von Bar, 2 *The Common European Law of Torts* 9 (Oxford, 2000).

[63] *Lauder v Czech Republic*, Final Award, Ad hoc—UNCITRAL Arbitration Rules; IIC 205 (2001).

[64] *Biwater Gauff (Tanzania) Ltd v Tanzania*, Award, ICSID Case No ARB/05/22; IIC 330 (2008).

[65] See p. 29 *supra* (satisfaction is appropriate for injury to States).

[66] See Arangio-Ruiz, *1989*, *supra* note 40, at 6-7 (*citing Janes case*, 4 UNRIAA 82 (1925); *Francisco Mallen Case*, decision of 27 April 1927, 4 RIAA 173 (1927); *Stephens Brothers Case*, decision of 15 July 1927, 4 RIAA 265 (1927).

of stepping into the murky waters of speculation. Thus, in some cases where the evidence of the loss has been tenuous, tribunals have awarded only so-called nominal damages. This was the case in the *Lighthouses Arbitration*[67] where the tribunal's symbolic award was 1 franc. As a policy matter, even a symbolic sum of 1 franc is better than nothing; otherwise the wrongdoer might repeat the breach after determining that it would be less costly to breach than to perform its obligations— practically an application of the efficient breach theory in contracts law.[68]

IX. Interest on Compensation for Moral Damage

In *Benvenuti & Bonfant,* the only ICSID case pre-*Desert Line* where a tribunal awarded compensation for moral damages, this compensation was equal to two percent of the principal award. In addition, the tribunal awarded interest on all the sums, including on compensation for moral damage. In *Desert Line*, however, as noted, the tribunal refrained from awarding interest on compensation for moral damages, stating that compensation for moral damages awarded was at the discretion of the tribunal. The *Desert Line* tribunal did not further elaborate on this, but there seems to be some historical support in international cases.[69]

Whether discretionary or not, post-award interest on compensation for moral damage seems appropriate as, at that point, the money now belongs to the claimant, and, until the time of payment, the claimant will lose the opportunity to invest it.

X. Conclusion

Moral damages have been neglected in investment treaty arbitration. *Desert Line v Yemen* reminded the investment arbitration community of the possibility of recovering compensation for such damages. Moral damages should be repaired as any other type of damage. Investment treaties generally do not limit jurisdiction of arbitral tribunals to compensate such damages. Further, to compensate moral damages, there is no need to prove fault on the part of the State. It is essential, however, that the counsel seek such damages and quantify them 'nearly *approximating accuracy as human ingenuity can devise*'.[70] It remains to be seen which methods will be used to quantify such damages.

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[67] *Lighthouses Arbitration* (Fr. V Greece) 23 ILR 659 (Perm. Ct. Arb. 1956).
[68] Pursuant to this theory 'a party should be allowed to breach a contract and pay damages, if doing so would be more economically efficient than performing under the contract'. Black's Law Dictionary 533 (8th ed., 2004).
[69] See, eg, *Janes Case*, supra note 66.
[70] *Lusitania*, supra note 2, at 36 (emphasis added).

At What Time Must Legitimate Expectations Exist?

Christoph Schreuer & Ursula Kriebaum*

I. Preliminary Remarks

The protection of legitimate expectations is by now firmly rooted in arbitral practice. The purpose of protecting legitimate expectations is to enable the foreign investor to make rational business decisions relying on the representations made by the host State. Legitimate expectations are closely linked to the requirements of stability and predictability. However, not every expectation upon which a business decision is taken is protected by international investment law.[1]

The Tribunal in *Thunderbird v Mexico*,[2] of which Thomas Wälde was a member, devoted considerable attention to the question of legitimate expectations. The Award identifies the requirements for the existence of legitimate expectations in the context of fair and equitable treatment in the following way:

> a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages.[3]

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[1] Generally on the significance of legitimate expectations see C Schreuer, Fair and Equitable Treatment in Arbitral Practice, (2005) 6 *The Journal of World Investment & Trade* 357, 374-380; E Snodgrass, 'Protecting Investors' Legitimate Expectations – Recognizing and Delimiting a General Principle' (2006) 21 *ICSID Review* – FILJ 1; S Fietta, 'The "Legitimate Expectations" Principle under Article 1105 NAFTA–*International Thunderbird Gaming Corporation v The United Mexican States*' (2006) 7 *The Journal of World Investment & Trade* 423; A von Walter, 'The Investor's Expectations in International Investment Arbitration' in A Reinisch, Ch Knahr (eds.), *International Investment Law in Context* (2008) 173; C Brown, 'The Protection of Legitimate Expectations as a 'General Principle of Law': Some Preliminary Thoughts' in *TDM*, January 2008; I Tudor, The Fair and Equitable Treatment Standard in the International Foreign Investment Law (OUP, 2008) 163.

[2] *International Thunderbird Gaming Corporation v The United Mexican States*, Award, 26 January 2006.

[3] At para 147.

Thomas Wälde, in his separate opinion, agreed on the test but not on its application to the facts of the case. In a detailed discussion of the concept[4] he stressed the role of legitimate expectations as an important part of the fair and equitable treatment (FET) standard under Article 1105 NAFTA. He said:

> One can observe over the last years a significant growth in the role and scope of the legitimate expectation principle, from an earlier function as a subsidiary interpretative principle to reinforce a particular interpretative approach chosen, to its current role as a self-standing subcategory and independent basis for a claim under the 'fair and equitable standard' as under Art. 1105 of the NAFTA.[5]

One of the issues surrounding the principle of legitimate expectations that deserves closer attention is the question of time: when do the expectations have to exist to merit the protection of international investment law?

II. The Time of the Legitimate Expectations

Pertinent treaty provisions in BITs give no indication of the time at which expectations must exist in order to be worthy of protection. But a number of tribunals have stated that protected expectations must rest on the conditions as they exist at the time of the investment.[6]

Some Tribunals have made this statement with regard to investment protection in general. They have pointed out that a foreign investor has to make its business decisions and shape its expectations on the basis of the law and the factual situation prevailing in the country as it stands at the time of the investment. The legal regime in place at the time of the investment is the starting point against which the treatment of the investment by the State will be assessed by an investment tribunal to decide whether an investment protection treaty was violated.

It is in this spirit that the Tribunal in *GAMI v Mexico*[7] held that its mandate was to assess how the legal regime in place at the time of the investment had been applied to the investor and not whether it was the proper legal regime:

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[4] Separate Opinion at paras. 21-58.
[5] At para 37.
[6] See also *Southern Pacific Properties (Middle East) Limited (SPP) v Arab Republic of Egypt*, Award, 20 May 1992, 3 ICSID Reports 189, paras 82, 83; *Saluka Investments BV (The Netherlands) v The Czech Republic*, Partial Award, 17 March 2006, para 329; *Azurix Corp. v Argentine Republic*, Award, 14 July 2006, para 372; *Siemens A.G. v Argentine Republic*, Award, 6 February 2007, para 299; *Duke Energy Electroquil Partners & Electroquil S.A. v Republic of Ecuador*, Award, 18 August 2008, paras 340, 347, 365, 366.
[7] *GAMI Investment Inc. v Mexico*, (NAFTA), Award, 15 November 2004.

> 93. To repeat: NAFTA arbitrators have no mandate to evaluate laws and regulations that predate the decision of a foreigner to invest. …
> 94. The duty of NAFTA tribunals is rather to appraise whether and how preexisting laws and regulations are applied to the foreign investor.[8]

A number of Tribunals explicitly applied this general approach to the concept of legitimate expectations. They held that the expectations that an investor had when it made the investment are decisive.

In *Tecmed v Mexico*,[9] one of the leading cases on fair and equitable treatment and on the investor's legitimate expectations, the Tribunal said that for a violation of FET the investor must have relied on his expectations when making the investment, thereby implying that the investor's expectations must have existed at the time of the investment. At the beginning of its famous and often quoted passage on investor expectations the Tribunal said:

> 154. The Arbitral Tribunal considers that this provision of the Agreement, 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.[10]

Other Tribunals were even more explicit with regard to the timing of expectations. In *LG&E v Argentina*,[11] the Claimant owned a shareholding interest in three local gas distributing companies in Argentina. Argentina interfered with expectations which were based on the license of the local companies and the laws and regulations in force at the time of the investment. The Tribunal, quoted the passage from *Tecmed*, cited above.[12] It said with regard to the time component of the legitimate expectations:

> 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.[13]

Enron v Argentina[14] concerned Enron's indirect investment of 35.5% in Transportadora Gas del Sur ('TGS'), one of the major Argentine networks for the transportation and distribution of gas. Argentina had offered by

[8] At paras 93, 94.
[9] *Tecnicas Medioambientales Tecmed S. A. v The United Mexican States*, Award, 29 May 2003, 43 ILM 133 (2004).
[10] At para 154.
[11] *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc.v Argentine Republic*, Decision on Liability, 3 October 2006, 21 ICSID Review (2006) 203.
[12] At para 127
[13] At para 130.
[14] *Enron Corporation and Ponderosa Assets, L.P. v Argentine Republic*, Award, 22 May 2007.

means of the Argentine Gas Law, the Gas Decree and the Basic Rules of the License key tariff-related guarantees. The Tribunal noted that it was essential for the protection of legitimate expectations that they existed at the time of the investment and were part of the considerations of the investor to invest:

> 262. The protection of the '*expectations that were taken into account by the foreign investor to make the investment*' has likewise been identified as a facet of the standard. …What seems to be essential, however, is that these expectations derived from the conditions that were offered by the State to the investor at the time of the investment and that such conditions were relied upon by the investor when deciding to invest.[15]

Claimant in *BG v Argentina*[16] had a direct and indirect investment in MetroGas a natural gas distribution company incorporated in Argentina. The Tribunal relied on the characterisation of legitimate expectations by the *LG&E* Tribunal.[17] It said:

> 298. The duties of the host State must be examined in the light of the legal and business framework as represented to the investor at the time that it decides to invest.[18]

National Grid v Argentina[19] concerned a shareholding in a local investment vehicle which had obtained a concession for providing high-voltage electricity transmission services in Argentina. The Tribunal stated that the expectations that had existed and were relied upon by the investor at the time of the investment were protected:

> 173. A review of the case law adduced by the Parties shows … that this standard protects the reasonable expectations of the investor at the time it made the investment and which were based on representations, commitments or specific conditions offered by the State concerned. Thus, treatment by the State should 'not affect the basic expectations that were taken into account by the foreign investor to make the investment.[20]

These decisions focus on one particular point in time: the establishment of the investment. At first sight this approach appears eminently reasonable. The causal nexus between the investor's legitimate expectations and the investment can only exist in relation to contemporary expectations. This leads to the question whether 'the time of the investment' can always be determined with accuracy. In particular, it may be open to doubt

[15] At para 262. Footnotes omitted. Italics original.
[16] *BG Group Plc v Republic of Argentina*, Final Award, 24 December 2007.
[17] At para 297.
[18] At para 298.
[19] *National Grid v Argentina*, Award, 3 November 2008.
[20] Footnotes omitted.

whether an investment is necessarily a one time event that can be reduced to a particular date.

III. Investment as a Complex Process

An investment is often a process rather than an instantaneous act. This implies that it will often not be a single step on the basis of a single decision that needs to be taken. Rather, during the process of establishing an investment as well as during the lifetime of an investment project, a number of business decisions have to be taken by investors. To take a relatively simple example: shares of a local company are sometimes acquired in several steps over time rather than at once.

This was the case in *CMS v Argentina*.[21] CMS's shareholding in TGN was not established at once. First CMS purchased 25% of the company, later it acquired an additional 4,42%.[22] In *Eureko v Poland*[23] the central issue was the foreign investor's right to acquire additional shares of a Polish insurance company at a later point in time including the right to acquire majority control.

Sempra v Argentina[24] can also serve as an example for an investment that took place in instalments. The Tribunal described this process in the following terms:

> 88. The Claimant explains that it indirectly owns 43.09% of the shares of Sodigas Sur and Sodigas Pampeana, which in turn, respectively, own 90% and 86.09% of the distribution licensees CGS and CGP. The investment began in April 1996 when the Claimant acquired a 12.5% interest in Sodigas Pampeana and Sodigas Sur from Citicorp Equity Investment for the amount of U.S. $ 48.5 million.
> 89. This participation was increased in March 1998 when the Claimant acquired an additional 9% interest in the Licensees from the Argentine company Loma Negra for an amount of U.S. $ 42.4 million, thus totalling an interest of 21.545%.
> 90. Ownership was further increased in October 2000 when the Claimant acquired shares in the Licensees for U.S. $ 159.4 million from Consolidated Natural Gas, thus doubling its participation to a total of 43.09%. Also in October 2000 Sodigas Pampeana acquired in auction from the Government of Argentina an additional 6.35% interest in CGP, totalling a 77.21% interest. On October 11, 2000, Camuzzi Argentina transferred to Sodigas Pampeana an 8.88% direct interest in CGP, which increased Sodigas Pampeana's interest in CGP to the current 86.09%.[25]

[21] *CMS Gas Transmission Company v Argentine Republic*, Award, 12 May 2005, 44 ILM (2005) 1205.
[22] At para 58.
[23] *Eureko B.V v Republic of Poland*, Partial Award, 19 August 2005, 12 ICSID Reports 335.
[24] *Sempra Energy International v Argentine Republic*, Award, 28 September 2007.
[25] At paras 88-90.

BG v Argentina[26] is a further example of a successive acquisition of shares. Between 1994 and 1998 BG increased its investment in MetroGAS from 28.7% to 45.11%.[27]

These cases demonstrate that investments can take place incrementally over a certain period of time. The host State may well take steps during that period that create legitimate expectations with the foreign investor and have an impact on its further investment decisions. If a dispute were later to arise from the frustration of these expectations, it would be for the tribunals to identify the expectations relevant to particular investment decisions.

In addition, a typical investment is not a simple event. An investment operation is often composed of a number of diverse transactions and activities, which must be treated as an integrated whole. Therefore, an investment is often a complex process involving diverse transactions which have a separate legal existence but a common economic aim.

To a certain extent this is already reflected in the definition of 'investment' contained in BITs and other treaties covering a variety of different rights and transactions. Most investment protection treaties contain broad definitions of 'investment'. The definition of 'investment' in Article 1(6) of the Energy Charter Treaty is typical of these comprehensive definitions:

> 'Investment' means every kind of asset, owned or controlled directly or indirectly by an Investor and includes:
> (a) tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges;
> (b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise;
> (c) claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment;
> (d) Intellectual Property;
> (e) Returns;
> (f) any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.

The various assets listed in these definitions should not necessarily be seen as alternatives. Each of them may well constitute an investment in its own right. But in many if not most investment situations they will arise in combination. Typically, it is the acquisition and deployment of

[26] *BG Group Plc v Republic of Argentina*, Final Award, 24 December 2007.
[27] At paras 24-26.

several or all of these various assets that combine into an investment operation.

Tribunals have emphasized repeatedly that what mattered for the existence of an investment was not so much ownership of specific assets but rather the combination of rights that were necessary for the economic activity at issue. This doctrine of the 'general unity of an investment operation' was set out already in the very first case that came before an ICSID tribunal, *Holiday Inns v Morocco*.[28] In that case, the agreement for the establishment and operation of hotels had also provided for financing by the Government by means of separate loan contracts. The Respondent objected to the jurisdiction of ICSID over the claims connected with the loan contracts. The Tribunal rejected this contention and asserted its jurisdiction over the entire operation including the loan contracts. It emphasized the general unity of the investment operation. The Tribunal said:

> It is well known, and it is being particularly shown in the present case, that investment is accomplished by a number of juridical acts of all sorts. It would not be consonant either with economic reality or with the intention of the parties to consider each of these acts in complete isolation from the others. It is particularly important to ascertain which is the act which is the basis of the investment and which entails as measures of execution the other acts which have been concluded in order to carry it out.[29]

The classical formula for the doctrine of the general unity of an investment operation came from the Tribunal in *CSOB v Slovakia*.[30] The Tribunal observed that an investment is often composed of various elements some of which may qualify as investments in their own right but also included others that did not. In the context of jurisdiction under the ICSID Convention it described an investment as follows:

> An investment is frequently a rather complex operation, composed of various interrelated transactions, each element of which, standing alone, might not in all cases qualify as an investment. Hence, a dispute that is brought before the Centre must be deemed to arise directly out of an investment even when it is based on a transaction which, standing alone, would not qualify as an investment under the Convention, provided that the particular transaction forms an integral part of an overall operation that qualifies as an investment.[31]

[28] *Holiday Inns v Morocco*, Decision on Jurisdiction, 12 May 1974. The decision is unreported. A detailed account with extensive quotations was published by *Lalive*, The First 'World Bank' Arbitration (*Holiday Inns v Morocco*) – Some Legal Problems, 51 British Year Book of International Law 123 (1980); also in 1 ICSID Reports 645 (1993).
[29] At 159 (1980).
[30] *CSOB v Slovakia*, Decision on Jurisdiction, 24 May 1999, 5 ICSID Reports 335
[31] At para 72.

In *Enron v Argentina*,[32] the Respondent argued that a 'Transfer Agreement' did not qualify as an investment agreement or authorization in terms of the applicable BIT. The Claimants insisted that the investment was a process that was manifested in several instruments and that their claim concerned their rights as investors in the process as a whole. The Tribunal accepted the Claimants' position and said:

> The Tribunal notes in this context that an investment is indeed a complex process including various arrangements, such as contracts, licences and other agreements leading to the materialization of such investment, a process in turn governed by the Treaty. This particular aspect was explained by an ICSID tribunal as 'the general unity of an investment operation' and by one other tribunal considering an investment based on several instruments as constituting 'an indivisible whole'.[33]

In *Duke Energy v Peru*,[34] the parties had entered into a contract called the DEI Bermuda LSA which contained the arbitration clause that was the basis for jurisdiction in the case. The respondent argued that only the capital contribution foreseen in that contract was protected by the jurisdictional clause. The Tribunal rejected this argument. It found that the capital contribution was not an isolated transaction but was one of many transactions that were part of a single concerted effort of the Claimant's overall investment.[35] The Tribunal said:

> in determining their jurisdiction, ICSID tribunals have recognized the unity of an investment even when that investment involves complex arrangements expressed in a number of successive and legally distinct agreements.[36]

It follows from this consistent case law that tribunals, when examining the existence of an investment for purposes of their jurisdiction, have not looked at specific transactions but at the overall operation.[37] Tribunals have refused to dissect an investment into individual steps taken by the investor, even if these steps were identifiable as separate legal transactions. What mattered for the identification and protection of the investment was the entire operation directed at the investment's overall economic goal.

[32] *Enron v Argentina*, Decision on Jurisdiction, 14 January 2004.
[33] At para. 70. Footnotes omitted. The case references are to *Holiday Inns v Morocco* and to *Klöckner v Cameroon*.
[34] *Duke Energy v Peru*, Decision on Jurisdiction, 1 February 2006.
[35] At paras 92(2), 100, 102.
[36] At para 92(4).
[37] See also *PSEG v Turkey*, Decision on Jurisdiction, 4 June 2004, paras. 106-124, 11 ICSID Reports 434; *Joy Mining v Egypt,* Award, 6 August 2004, para. 54, 19 ICSID Review–FILJ (2004), (but see the apparent contradiction with the Tribunal's statement at paras. 42, 44); *Mitchell v DR Congo,* Decision on Annulment, 1 November 2006, para. 38; *Saipem v Bangladesh,* Decision on Jurisdiction, 21 March 2007, paras. 112-114, 22 ICSID Review–FILJ (2007).

The realization that an investment is often not a single right or an isolated transaction but a combination of rights and an integrated process of transactions is important also for the timing of the legitimate expectations upon which investment decisions rely. If the investment cannot be reduced to a one time event but is seen as a process, the identification of the relevant time for the existence of legitimate expectations becomes more difficult.

IV. The Investor's Reliance upon Legitimate Expectations

The acceptance of an investment as a complex processes involving a number of different transactions means that it is not possible to focus only on one particular point in time for the identification of legitimate expectations. Rather, it is necessary to identify the diverse transactions and activities, which combine to constitute the investment, and to examine individually whether they were based on contemporary legitimate expectations. In other words, it is necessary to ascertain the existence of legitimate expectations held by the investor at the time of each individual decision. The key issue is the actual reliance on expectations which existed at the particular point in time when the relevant decision was taken.

This differentiated approach to the time of the investment necessitates differentiation also with respect to the timing of the creation of expectations. There is no limited canon of governmental actions leading to legitimate expectations. To be able to rely on legitimate expectations the foreign investor must have knowledge, or at least access to knowledge of the facts on which the legitimate expectations are based. Furthermore, the foreign investor must have taken relevant business decisions on the basis of these facts.

Expectations can be created through the general regulatory framework prevalent in a country.[38] Expectations can also be created through specific transactions or governmental assurances. In some cases the expectations stemmed from the general regulatory framework as well as specific commitments contained in licenses. [39]

A foreign investor may be presumed to know the general regulatory framework prevalent in a country at the time it first embarks upon the

[38] *Enron Corporation and Ponderosa Assets, L.P. v Argentine Republic*, Award, 22 May 2007, at para 265.

[39] *BG Group Plc v Republic of Argentina*, Final Award, 24 December 2007, para. 307; *Sempra Energy International v Argentine Republic*, Award, 28 September 2007, paras. 148, 158; *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc.v Argentine Republic*, Decision on Liability, 3 October 2006, para. 133, 21 ICSID Review (2006) 203; *CMS Gas Transmission Company v Argentine Republic*, Award, 12 May 2005, paras. 275, 281.

investment. But it is not only the framework existing at that early stage that can create legitimate expectations. If there are favourable changes to the legal framework during the establishment or during the lifetime of the investment, this may also create legitimate expectations which will be protected if the foreign investor relies on them in subsequent business decision.

In some cases the legitimate expectations are based on specific assurances by the host State, whether in the form of contracts, licenses or otherwise. These specific assurances may have been given either before the first step in the investment process or at a later stage. If the investor relied on assurances given after the investment's inception and adapted its subsequent investment decisions accordingly, these assurances may have created expectations which deserve protection.

Duke Energy v Ecuador[40] gives some indication of a differentiated approach to the timing of legitimate expectations and the business decisions based on them. The dispute arose from contracts for the generation of electrical power in Ecuador between Electroquil S.A., an Ecuadorian company, and INECEL, a state-owned power company. In 1995 and 1996 INECEL entered into power purchase agreements (PPAs) with Electroquil. The US company Duke Energy acquired an ownership interest in Electroquil in 1998.[41] Both, Duke Energy and Electroquil were claimants before the ICSID tribunal.

The Tribunal conditioned the protection of legitimate expectations on their existence at the time of the investment and on the investor's actual reliance upon them when making the investment:

> 340. The stability of the legal and business environment is directly linked to the investor's justified expectations. The Tribunal acknowledges that such expectations are an important element of fair and equitable treatment. At the same time, it is mindful of their limitations. To be protected, the investor's expectations must be legitimate and reasonable at the time when the investor makes the investment. The assessment of the reasonableness or legitimacy must take into account all circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host State. In addition, such expectations must arise from the conditions that the State offered the investor and the latter must have relied upon them when deciding to invest.[42]

[40] *Duke Energy Electroquil Partners & Electroquil S.A. v Republic of Ecuador*, Award, 18 August 2008.

[41] Duke Energy is the sole parent company of Duke Energy International del Ecuador Cía Ltda ('Duke Ecuador' or 'DEI'), through which it acquired the ownership interest in Electroquil, on 23 February 1998.

[42] At para 340, footnotes omitted. See also para. 347.

The Tribunal explicitly excluded the protection of expectations that may have arisen from an agreement that had been entered into two years after the relevant investment had been made:

> 365. … the legitimate expectations which are protected are those on which the foreign party relied when deciding to invest. The Med-Arb Agreements were concluded more than two years later and can thus in no event give rise to expectations protected under the fair and equitable treatment standard.[43]

The Tribunal found a violation of the fair and equitable treatment clause of the BIT between Ecuador and the US. The Tribunal examined the existence of legitimate expectations in respect of the two claimants separately and in relation to different points in time.

The Tribunal held that Electroquil's expectations were embodied in the text of the PPAs concluded in 1995 and 1996.[44] The Tribunal said with respect to one of the PPAs:

> 359. … it appears that Electroquil entered into the PPA 96 with the expectation that the Ministry of Finance would comply with the payment mechanism provided in Clause 8.6 of PPA 96. The Ministry of Finance was to take part in the 96 Payment Trust and to provide a payment guarantee. In the Tribunal's opinion, the Ministry of Finance engaged the responsibility of the State at this juncture and it was reasonable for Electroquil to rely on the Ministry's express commitment.
> 361. … the Tribunal finds that Electroquil could reasonably rely on the State's representation that it would guarantee INECEL's payments under the 96 Payment Trust. Accordingly, the Tribunal is of the opinion that the Respondent failed to grant fair and equitable treatment to Electroquil's investment by not implementing the payment guarantee.[45]

With regard to Duke Energy the Tribunal took into consideration that it had only invested in 1998. The Tribunal examined the expectations it could have had at that later stage. It also took into consideration the knowledge Duke Energy had about facts which had occurred in the period prior to its investment. The Tribunal said with regard to Duke's expectations:

> 362. Duke Energy invested in a different context than Electroquil. It was aware of the circumstances surrounding the performance of the PPAs, in particular of the late payments and the imposition of heavy fines. As a result, it appears that Duke Energy requested certain guarantees from the State as a condition precedent to its investment, notably the Payment Decree and the establishment of the Payment Trusts (…).[46]

[43] At para 365. Footnote omitted.
[44] At para 356.
[45] At paras 359, 361.
[46] At para 362.

Therefore, the Tribunal examined separately for each of the two claimants the contemporary expectations on which their respective business decisions had rested. The Tribunal strictly adhered to the position that only the expectations held at the time of the investment were relevant. The local company's expectations had arisen before the foreign investor had become involved. Duke Energy's expectations had arisen from the totality of the information it had at its disposal when it made its investment in 1998.

V. Conclusions

The case law of arbitral tribunals suggests that the decisive element for the protection of legitimate expectations of foreign investors is reliance on general or specific assurances given by the host State at the relevant time. Where complex investment operations are involved, it may be impossible to reduce the relevant time to a particular date. Not infrequently, investments are made through several steps, spread over a period of time, through the acquisition and deployment of various assets. An investor typically makes important decisions not only when taking the first step towards the investment but also at a later stage during the lifetime of an investment project. If this is the case, legitimate expectations must be examined for each stage at which a decisive step is taken towards the creation, expansion, development or reorganisation of the investment.

Unlawful or Bad Faith Conduct as a Bar to Claims in Investment Arbitration

Abby Cohen Smutny and Petr Polášek*

I. Introduction

Many of the claims traditionally presented in investment arbitration center on allegations of unlawful or bad faith conduct attributable to a State. With the steady growth in the number of investment arbitrations, it is natural that focus occasionally turns to the conduct of the claimant investor.

As Professor Wälde observed in his separate Opinion in the *International Thunderbird Gaming* case, while investment protection treaties protect investors' legitimate expectations, such treaties do not protect expectations created by unlawful or abusive means:

> There is ample jurisprudence that a legitimate expectation protected by Art. 1105 of the NAFTA can not be created if deception, fraud or other illicit means were used to obtain the governmental assurance or other rights obtained from the government in this way. There can be no international treaty protection for rights obtained by illicit means. In such cases, there may be an expectation, but not a 'legitimate' one.[1]

While claims have been dismissed in a number of recent cases in circumstances where the tribunal was persuaded that the claimant had acquired or established its investment in a manner that constituted abusive or bad faith conduct (and these are discussed below), there have been, and likely will continue to be, many more cases where such claims are raised, but where the evidence is not sufficient to warrant a dismissal of the case on that basis. Indeed, it is instructive to bear in mind how often tribunals have addressed these issues.[2]

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[1] *International Thunderbird Gaming Corporation v United Mexican States*, UNCITRAL, Award of 26 January 2006, Separate Opinion of Prof. Wälde dated December 2005, *available at* http://ita.law.uvic.ca, para 112 (internal footnotes omitted).

[2] See eg *Franz Sedelmayer v the Russian Federation*, Award of 7 July 1998, pp 8, 65-67 (majority dismissing Russia's argument that a jointly-held company had not been established in accordance with Russian law and thus outside the BIT's definition of an investment 'in accordance with the [host State's] legislation'); *SwemBalt AB v the Republic of Latvia*, *Cont.*

It is significant to consider, therefore, the legal context in which the several objections regarding the investor's conduct that have succeeded were raised and the grounds for dismissal in those cases.

UNCITRAL, Award of 23 October 2000, paras 15, 31-35 (dismissing Latvia's argument that the investment was outside the BIT's definition of an investment 'made in accordance with the laws and regulations of the [host State]' because certain lease agreements were allegedly invalid and the investment activity allegedly commenced prior to the registration of a local company in violation of Latvian law); *Wena Hotels Limited v Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Award of 8 December 2000, paras 76, 111-117 (accepting Egypt's argument that if the claimant obtained hotel leases by corruption, it would be grounds for dismissal of claims, but rejecting objection for lack of evidence, noting Egypt's failure to prosecute a government official in question); *SGS Société Générale de Surveillance S.A. v Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision on Objections to Jurisdiction of 6 August 2003, paras 78, 141-143 (Pakistan reserved a jurisdictional objection to the effect that if ongoing criminal investigations were to conclude that SGS procured its investment agreement by bribery and fraud, it would mean that SGS did not invest 'in accordance with the laws and regulations of' Pakistan as required by the BIT, but objection not raised prior to the tribunal's decision); *Tokios Tokelės v Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction of 29 April 2004, paras 17, 83-86 (majority holding that investment complied with BIT definition 'in accordance with the laws and regulations' as alleged defects in certain documents underlying registrations of the investment by Ukrainian authorities were 'minor'); *Industria Nacional de Alimentos, S.A. and Indalsa Perú, S.A. (formerly Empresas Lucchetti, S.A. and Lucchetti Perú, S.A.) v Republic of Peru*, ICSID Case No. ARB/03/4, Award of 7 February 2005, paras 25-37 (not reaching Peru's objection that the claimants' investment was not 'made in accordance with the laws and regulations' of the host State as the BIT required because claimants allegedly violated various Peruvian laws and regulations in constructing and operating pasta factory in Peru); *Aguas del Tunari S.A. v Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Objections to Jurisdiction of 21 October 2005, paras 156-192 (rejecting Bolivia's objection to jurisdiction on the basis that changes in the claimant's corporate structure allegedly breached concession contract and that claimant's representatives allegedly misrepresented the corporate structure to Bolivia); *Saluka Investments BV v Czech Republic*, UNCITRAL, Partial Award of 17 March 2006, paras 202-221 (concluding that while the BIT did not define an investment with reference to the host State's law, it was nonetheless implicit that 'an investment must have been made in accordance with the provisions of the host State's laws,' the Czech Republic failed to persuade that Saluka's acquisition of shares was not in accordance with Czech law); *Vladimir Berschader and Moïse Berschader v the Russian Federation*, SCC Case No. 080/2004, Award of 21 April 2006, paras 47, 111 (although dismissing the case on other grounds, concluding that under the BIT's definition of investment, which included investments 'in accordance with [the host State's] legislation,' the lawfulness of the investment was 'not an issue affecting the jurisdiction … but rather [was] a substantive issue pertaining to the merits'); *Ioannis Kardassopoulos v Georgia*, ICSID Case No. ARB/05/18, Decision on Jurisdiction of 6 July 2007, paras 49, 182-184 (dismissing objection that there was no investment in view of BIT requirement that pre-existing investments be 'consistent with the [host State's] legislation' because any alleged illegality relating to the investment was caused by an excess of authority on the part of Georgian State-owned enterprises, and not by the investor); *African Holding Company of America, Inc. and Société Africaine de Construction au Congo S.A.R.L. v Democratic Republic of the Congo*, ICSID Case No. ARB/05/21, Award of 29 July 2008, paras 48-56 (rejecting an objection to jurisdiction based on general allegations of corruption during the Mobutu period due to inadequate specific evidence of corrupt acts); and *RSM Production Corporation v Grenada*, ICSID Case No. ARB/05/14, Award of 13 March 2009, paras 397-461 (rejecting on the facts Grenada's allegation that claimant engaged in various misrepresentations that allegedly provided grounds under Grenadian law for rescinding the agreement, which included an agreement to submit disputes to ICSID arbitration). The foregoing decisions and awards are available at http://icsid.worldbank.org, http://ita.law.uvic.ca and/or http://www.investmentclaims.com.

II. Société d'Investigation de Recherche et d'Exploitation Minière (SIREXM) v Burkina Faso[3]

Société d'Investigation de Recherche et d'Exploitation Minière (SIREXM) v Burkina Faso was an arbitration under the ICSID Convention of a contract dispute arising out of an Agreement for gold mining operations concluded between Burkina Faso and *Société d'Ingénierie et de Réalisations à l'Exportation* (SIREX), a company incorporated under the laws of France.[4]

Pursuant to the Agreement, the parties established a Burkinabe mining research and exploitation company, *Compagnie d'Exploitation de Mine d'Or au Burkina* (CEMOB),[5] and SIREX assigned its rights and obligations under the Agreement to the claimant, SIREXM, another French company, this one specifically created to carry out the Agreement.[6]

In the course of executing the Agreement, CEMOB took steps to increase its capital without Burkina Faso's participation and over its objections and with the result that Burkina Faso's ownership percentage in CEMOB decreased.[7] Burkina Faso thereafter placed CEMOB in receivership and sought the termination of the Agreement.[8]

SIREXM initiated ICSID arbitration.[9] After SIREXM presented its memorial on the merits, Burkina Faso appears to have raised objections to the Tribunal's jurisdiction.[10] Those objections were ultimately joined to the merits.

Burkina Faso appears to have claimed that SIREX/SIREXM failed to disclose to Burkina Faso that an employee of the Ministry of Industry, Commerce and Mines, who later became the general director of CEMOB, also was a shareholder of SIREXM,[11] and that the Government representatives had a reasonable basis to assume that the director, as a Ministry employee, would have disclosed this relationship to the Government.[12] Burkina Faso appears to have claimed this situation created a conflict of interest and that if it had been properly informed, it would not have concluded the Agreement in the first place.

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[3] *Société d'Investigation de Recherche et d'Exploitation Minière v Burkina Faso*, ICSID Case No. ARB 97/1, Excerpts of Award of 19 January 2000, *available at* http://icsid.worldbank.org.
[4] Introductory Note, *Société d'Investigation de Recherche et d'Exploitation Minière (SIREXM) v Burkina Faso* (ICSID Case No. ARB/97/1), *available at* http://icsid.worldbank.org.
[5] ibid.
[6] ibid.
[7] ibid.
[8] ibid.
[9] ibid.
[10] ibid.
[11] *SIREXM v Burkina Faso*, Excerpts of Award, paras 5.13, 5.29.
[12] ibid.

The Tribunal considered whether the Agreement was valid with reference to the applicable law and general contract principles of good faith and fair dealing.[13] The Tribunal noted that it is a classic principle of contract law that a person may not perform a role that creates a conflict of interest, at least not without informing the parties involved,[14] and that it is a basic principle of corporate law that shareholders must be kept informed with respect to the relationships that a director of the company may have with a co-contracting group.[15]

The Tribunal was persuaded on the basis of the evidence presented that the Agreement had been concluded based upon a fraudulent misrepresentation.[16] Notably the Tribunal observed that it was not necessary to determine in the circumstances whether Burkina Faso would have agreed to execute the Agreement if it had been accurately informed given the systematic reticence of SIREX/SIREXM on the issue, which the Tribunal concluded was probative on its face.[17]

Burkina Faso also appears to have objected that the Agreement violated public policy. The Tribunal held that in considering the legal consequences of the facts, it had to look beyond the internal public policy of Burkina Faso to determine whether the purpose was to commit a crime or whether the 'impulsive and decisive cause was illegal or immoral.'[18] In this case, the Tribunal concluded that the Agreement was null due to violation of public policy.[19]

On that basis, the Tribunal dismissed SIREXM's claims, finding that the Agreement was invalid on grounds of fraudulent misrepresentation (*dol*) and public policy.[20]

III. Inceysa v El Salvador[21]

Inceysa v El Salvador was an arbitration under the ICSID Convention of a dispute arising under the El Salvador-Spanish bilateral investment treaty.

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[13] ibid paras 5.01-5.44.
[14] ibid para 5.29.
[15] ibid.
[16] ibid.
[17] ibid, para 5.33 ('*Le fait même de la réticence systématique de SIREX/SIREXM sur ce point est probant*.'). ['The very fact of the systematic reticence of SIREX/SIREXM on this issue is probative.']
[18] ibid, para 5.39.
[19] ibid, para 5.41.
[20] ibid, paras 5.01-5.44.
[21] *Inceysa Vallisoletana S.L. v Republic of El Salvador*, ICSID Case No. ARB/03/26, Award of 2 August 2006, *available at* http://ita.law.uvic.ca.

Inceysa had won an exclusive concession contract for vehicle inspection services in El Salvador in a public bidding process organized by the Ministry of the Environment and Natural Resources. When a dispute arose between Inceysa and the Ministry, the project was not implemented and the Ministry awarded contracts to other companies.[22] Inceysa commenced arbitration.

El Salvador objected to the tribunal's jurisdiction, claiming that Inceysa had obtained the concession contract by fraud and that the BIT therefore did not apply to Inceysa's investment.[23] In light of these objections, the tribunal decided to address the issues presented in a separate jurisdictional phase.[24]

Following an examination of the evidence presented, the tribunal found, as a matter of fact, that during the bidding process Inceysa (i) submitted false financial information;[25] (ii) 'failed to tell the truth concerning the identify of its strategic partner' and 'also lied about the experience of its strategic partner';[26] (iii) misrepresented its own corporate history and experience;[27] (iv) submitted false information concerning the experience of its sole administrator;[28] and (v) concealed that it was affiliated with a company that was the runner-up in the bid, a 'deceit on one of the central aspects of the bid.'[29]

In view of those facts, the tribunal considered that the nature of the issue presented by El Salvador's objection was whether El Salvador had given its consent to submit the dispute to ICSID arbitration. According to the tribunal, this was an issue of jurisdiction '*rationae voluntatis*,' *i.e.*, whether the investment that was made was included among those 'protected by' the bilateral investment treaty.[30] The tribunal considered that it thus was presented with the question whether the consent to submit disputes to ICSID arbitration extended to disputes regarding 'investments not made in accordance with' the law of El Salvador.[31]

The El Salvador–Spanish bilateral investment treaty did not define the term investment by reference to a requirement regarding compliance with law. Article II of the BIT regulating 'Promotion and Admission' of investments provided that the treaty would apply to 'investments

[22] ibid, paras 22-36.
[23] ibid, paras 45-62.
[24] ibid, paras 12-15.
[25] ibid, para 110.
[26] ibid, paras 111-116.
[27] ibid, paras 117, 118.
[28] ibid, para 122.
[29] ibid, para 123.
[30] ibid, paras 144-145.
[31] ibid, para 156.

made before its entry into force by the investors of a Contracting Party *in accordance with the laws of the other Contracting Party*,'[32] and Article III of the BIT regulating 'Protection,' provided that '[e]ach Contracting party shall protect in its territory the *investments made, in accordance with its legislation*….'[33]

Although the claimant therefore urged that the issue of compliance with the laws of El Salvador was a substantive defense, the tribunal disagreed, concluding that 'if it is determined that the investment is not protected by the [BIT], it would imply recognizing that the necessary premise for … jurisdiction was not met.'[34]

The tribunal considered relevant in this regard that the *travaux préparatoires* of the BIT showed that El Salvador requested that the phrase 'in accordance with law' be included with reference to the definition of covered investments and that Spain replied that that was not necessary because other provisions of the BIT made clear that an investment must be made in accordance with the host State's law as a 'necessary condition for an investment to benefit' from the BIT.[35] Taking the provisions of the BIT into consideration together with the *travaux*, the tribunal therefore concluded that the BIT 'leaves investments made illegally outside of its scope and benefits.'[36]

Thus, the tribunal concluded that the consent to submit disputes to arbitration set forth in the BIT

> is limited to investments made in accordance with the laws of the host State of the investment. Consequently this tribunal decides that the disputes that arise from an investment made illegally are outside the consent granted by the parties and, consequently, are not subject to the jurisdiction of [ICSID], and that this Tribunal is not competent to resolve them….[37]

The tribunal considered that the question of jurisdiction in Inceysa's case depended upon whether the investment at issue was made in accordance with the laws of El Salvador. In that context, the tribunal emphasized that 'it is important to repeat that, as the legality of the investment is a premise for this Tribunal's jurisdiction, the determination of such legality can only be made by the tribunal hearing the case, *i.e.*, by this Arbitral Tribunal.'[38] As such, according to the tribunal, 'any resolutions

[32] ibid, para 204 (citing BIT – emphasis added).
[33] ibid, para 201 (citing BIT – emphasis added).
[34] ibid, para 160.
[35] ibid, para 196.
[36] ibid, para 206.
[37] ibid, para 207.
[38] ibid, para 209.

or decisions made by the State parties to the [BIT] concerning the legality or illegality of the investment are not valid or important for the determination of whether they meet the requirements of Article 25 of the ICSID Convention and of the BIT.'[39] The tribunal explained:

> Sustaining an opinion different than the one described above would imply giving signatory States of agreements for reciprocal protection of investments that include the 'in accordance with law' clause the power to withdraw their consent unilaterally (because they would have the power to determine whether an investment was made in accordance with their legislation), once a dispute arises in connection with an investment.[40]

On that basis, the tribunal dismissed Inceysa's argument that the validity of its investment had been confirmed by El Salvador's Supreme Court of Justice when it affirmed the outcome of the public tender that had been challenged by unsuccessful participants in the tender.[41]

The tribunal then analyzed whether the investment was made in accordance with the law of El Salvador. It found that by operation of El Salvador's Constitution, the BIT was part of the law of El Salvador, and the BIT thus was 'the primary and special legislation this Tribunal must analyze to determine whether Inceysa's investment was made in accordance with the legal system of [El Salvador].'[42] The tribunal considered that the BIT in turn provided that the 'arbitration will be based on … the provisions of this Agreement …; generally recognized rules and principles of International Law; [and] the national law of the [host State].'[43] The tribunal concluded that because the BIT did not contain 'substantive rules that permit a determination whether Inceysa's investment was made in accordance with the law of El Salvador, … the Tribunal must analyze other legal instruments to decide this issue.'[44]

The tribunal therefore turned to the 'generally recognized rules and principles of International Law,' which it equated with the 'general principles of law' referenced in Article 38 of the Statute of the International Court of Justice.[45]

The tribunal identified four general principles. First, it held that by its acts in the bidding process, Inceysa violated the principle of good faith, a 'supreme principle'[46] which in the contractual field means 'absence of de-

[39] ibid, para 210.
[40] ibid, para 211.
[41] ibid, para 212.
[42] ibid, paras 219, 220.
[43] ibid, para 222.
[44] ibid, para 223.
[45] ibid, paras 224-228.
[46] ibid, para 230.

ceit and artifice during the negotiation and execution of instruments that gave rise to the investment, as well as loyalty, truth and intent to maintain the equilibrium between the reciprocal performance of the parties.'[47] According to the tribunal, '[b]y falsifying the facts, Inceysa violated the principle of good faith from the time it made its investment.'[48]

Second, the tribunal held that the investments made by Inceysa also violated the principle *nemo auditur propriam turpitudinem allegans*, as expressed in various maxims such as *ex dolo malo non oritur actio* (an action does not arise from fraud) and *nemini dolos suusprodesse debet* (nobody may profit from his own fraud).[49] According to the tribunal, this principle has the consequence that a 'foreign investor cannot seek to benefit from an investment effectuated by means of one or several illegal acts and, consequently, enjoy the protection granted by the host State, such as access to international arbitration to resolve disputes.'[50]

Third, the tribunal held that not to exclude the claimant's investment from the protection of the BIT would be a violation of international public policy, that the inclusion of the clause 'in accordance with law' in various BIT provisions was 'a clear manifestation of said international public policy, which demonstrates the clear and obvious intent of the signatory States to exclude from its protection investments made in violation of the internal laws of each of them,'[51] that it was 'uncontroversial that respect for the law is a matter of public policy not only in El Salvador, but in any civilized country,' and that 'there is a meta-positive provision that prohibits attributing effects to an act done illegally.'[52]

Finally, the tribunal observed that the manner in which Inceysa made its investment violated the legal principle that prohibits unlawful enrichment.[53]

The tribunal concluded that 'because Inceysa's investment was made in a manner that was clearly illegal, it is not included within the scope of consent expressed by Spain and … El Salvador in the BIT and, consequently, the disputes arising from it are not subject to the jurisdiction of the Centre.'[54] The tribunal dismissed the case accordingly.

[47] ibid, para 231.
[48] ibid, para 239.
[49] ibid, para 240.
[50] ibid, para 242.
[51] ibid, para 246.
[52] ibid, para 248.
[53] ibid, paras 253, 254.
[54] ibid, para 257. The tribunal also held that Inceysa cannot invoke an ICSID clause in El Salvador's investment law because under the laws of El Salvador, access to that clause was premised on the investment having been made in compliance with the laws of El Salvador. ibid, paras 258-264.

IV. World Duty Free v Kenya[55]

World Duty Free v Kenya involved a company incorporated in the Isle of Man that concluded a contract with Kenya for the development and operation of duty-free complexes at two Kenyan airports.[56] The contract, which was governed by both English and Kenyan law, provided for ICSID arbitration.[57]

After disputes arose, the claimant commenced arbitration under the ICSID Convention alleging various breaches of the contract and other wrongdoings by Kenya.[58] Following the commencement of the proceedings, Kenya submitted an application to the tribunal claiming that the contract at issue was procured by bribery and was therefore unenforceable.[59]

The parties did not dispute the following facts. Prior to the conclusion of the contract, claimant's principal, Mr. Ali, consulted with a business contact connected to Kenya's then-President as to the necessary licenses and authorizations for the investment, and was advised that he should make a US$ 2 million 'personal donation' to the President. Mr. Ali accordingly transferred US$ 2 million to the business contact, US$ 500,000 of which (converted into Kenyan schillings) was handed over to the President in cash during an audience the President granted to Mr. Ali and the business contact. The President then approved the proposed contract and investment.

At issue in the case was the legal consequence of those facts. According to Kenya, the payment was an illegal bribe made for the purpose of obtaining an approval of the investment that warranted the dismissal of the case on the merits as a matter of Kenyan and English law as well as of international public policy. According to the claimant, however, the payment was in line with a local custom, and Mr. Ali believed that the payment was lawful.[60]

The tribunal concluded that 'the concealed payments made by Mr. Ali … could not be considered as a personal donation for public purposes' but 'must be regarded as a bribe made in order to obtain the conclusion of the 1989 Agreement.'[61]

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[55] *World Duty Free Company Limited v Republic of Kenya*, ICSID Case No. ARB/00/7, Award of 4 October 2006, available at http://ita.law.uvic.ca.
[56] ibid, para 62.
[57] ibid, paras 158, 159. This case did not involve an investment protection treaty.
[58] ibid, paras 68-79.
[59] ibid, para 105.
[60] ibid, paras 130, 133-135.
[61] ibid, para 136.

The tribunal then considered whether the claims must be dismissed as a matter of international public policy. It referred to international policy in the sense of an 'international consensus as to universal standards and accepted norms of conduct that must be applied in all fora,' also known as 'transnational public policy.'[62] As to the content of such norms, the tribunal stressed that 'Tribunals must be very cautious … and must carefully check the objective existence of a particular transnational public policy rule in identifying it through international conventions, comparative law and arbitral awards.'[63]

As to the rule implicated by that case, the tribunal took note of the universal condemnation of bribery in various international treaties and by various international bodies, in domestic laws and courts, and in a number of decisions by international arbitral tribunals.[64] It observed that while some arbitral tribunals recognized that in some countries and in some industries corruption was widespread and the award of a contract without a corrupt payment was difficult or impossible, international tribunals have 'always refused to condone such practices.'[65] On that basis the tribunal found that 'bribery is contrary to the international public policy of most, if not all, States or, to use another formula, to transnational public policy,' and held that 'claims based on contracts of corruption or on contracts obtained by corruption cannot be upheld by this Arbitral Tribunal.'[66]

The tribunal also considered English and Kenyan law and concluded that under English and Kenyan public policy, the claimant 'is not legally entitled to maintain any of its pleaded claims in these proceedings on the ground of *ex turpi causa non oritur actio*.'[67]

Considering the fact that Kenya thus succeeded in 'advancing as a complete defence to the Claimant's claims the illegalities of its own former President,'[68] the tribunal observed that '[t]he answer, as regards public policy, is that the law protects not the litigating parties but the public; or in this case, the mass of tax-payers and other citizens making up one of the poorest countries in the world.'[69]

With regard to the question whether the bribery defeated the tribunal's jurisdiction, the tribunal observed that there was no evidence or

[62] ibid, paras 138, 139.
[63] ibid, para 141.
[64] ibid, paras 142-156.
[65] ibid, para 156.
[66] ibid, para 157.
[67] ibid, para 179.
[68] ibid, para 180.
[69] ibid, para 181.

argument to the effect that agreement to submit disputes to ICSID was specifically procured by bribery, and therefore, 'in accordance with well-established legal principles under English and Kenyan law, the Tribunal operates on the assumption that the Parties' arbitration agreement remains subsisting valid and effective for the purpose of this proceeding and Award.'[70]

The tribunal therefore held that the claimant 'is not legally entitled to maintain any of its pleaded claims in these proceedings as a matter of *ordre public international* and public policy under the contract's applicable laws.'[71] The claimant's claims were dismissed accordingly.

V. Fraport v The Philippines[72]

In *Fraport v The Philippines*, the claimant Fraport presented claims under the Germany-Philippines bilateral investment treaty to arbitration under the ICSID Convention.

Fraport had invested in a Philippine company known as PIATCO that was a party to a concession contract for the construction and operation of an international airport terminal in Manila.[73] Prior to the completion of the terminal, disputes arose between Fraport and PIATCO and the Philippine Government, and the Philippine Supreme Court ruled that PIATCO's concession contract was null and void. Fraport commenced arbitration.[74]

The Philippines raised jurisdictional objections that were joined to the merits claiming that Fraport's investment in PIATCO violated nationality restrictions in the Philippine Constitution and the Anti-Dummy Law relating to those restrictions, and that its investment therefore did not fall within the scope of covered investments as defined by the BIT.[75]

[70] ibid, para 187. Thus, the tribunal did not explicitly address the question whether the bribe may have defeated ICSID jurisdiction under international law which applies to the question whether the requirements of consent set forth in Article 25 of the ICSID Convention are met. See *Československá obchodní banka, a. s. v Slovak Republic*, ICSID Case No. ARB/97/4, Decision on Objections to Jurisdiction of 24 May 1999, *available at* http://icsid.worldbank.org, para 35 ('The question of whether the parties have effectively expressed their consent to ICSID jurisdiction is not to be answered by reference to national law. It is governed by international law as set out in Article 25(1) of the ICSID Convention.').
[71] *World Duty Free v Kenya* para 188.
[72] *Fraport AG Frankfurt Airport Services Worldwide v Republic of the Philippines*, ICSID Case No. ARB/03/25, Award of 16 August 2007, *available at* http://ita.law.uvic.ca. See also Dissenting Opinion of Mr. Bernando M. Cremades dated 19 July 2007, *available at* http://ita.law.uvic.ca. An annulment proceeding is pending. Ms. Smutny served as counsel to the Philippines in the arbitration and serves as counsel in the currently pending annulment proceeding. Mr. Polášek served as a member of the Philippines' defense team.
[73] *Fraport v The Philippines*, Award, para 2.
[74] ibid, paras 77-225.
[75] ibid, paras 285-291.

Upon consideration of all the evidence presented in the case, including among other things secret shareholder agreements, the tribunal was 'persuaded from Fraport's own internal and contemporaneous documents that it was consistently aware that the way it was structuring its investment in the Philippines was in violation of the [Anti-Dummy Law] and accordingly sought to keep those arrangements secret.'[76]

The tribunal then considered whether Fraport's investment fell within the scope of the BIT's coverage, characterizing the issue as relating to jurisdiction *rationae materiae*.[77] Noting the absence of a definition of 'investment' in the ICSID Convention, the tribunal observed that the definition of an 'investment' in the pertinent BIT 'serves as a *lex specialis* with respect to Article 25 of the Washington Convention.'[78] The tribunal noted that where a BIT defines the term 'investment,' 'it is possible that an economic transaction that might qualify *factually and financially* as an investment … falls, nonetheless, outside the jurisdiction of the tribunal established under the pertinent BIT, because *legally* it is not an 'investment' within the meaning of the BIT.'[79]

The tribunal took note of several provisions relating to the BIT. Article 1(1) of the Germany-Philippines BIT defined 'investment' as 'any kind of asset accepted in accordance with the respective laws and regulations of either Contracting State.'[80] Article 2(1) of the BIT regulating 'Promotion and Acceptance' of investments provided that each Contracting Party 'shall promote as far as possible investments in its territory by investors of the other Contracting State and admit such investments in accordance with its Constitution, laws and regulations as referred to in Article 1, paragraph 1.'[81] The Protocol to the BIT referred to a prohibition in the Philippine Constitution of foreign ownership of land,[82] and the Philippines' instrument of ratification of the BIT exchanged with Germany stated that the BIT 'provides that the investment shall be in the areas allowed by and in accordance with the Constitutions, laws and regulations of each of the Contracting Parties.'[83]

In interpreting the BIT and the relevance of compliance with the law of the host State, the tribunal considered that these four references noted indicated the 'significance of this condition,' and that '[t]he parties had in mind explicit constitutional limitations in the Philippines.'[84] The

[76] ibid, para 332.
[77] ibid, para 307.
[78] ibid, para 305.
[79] ibid, para 306 (emphasis in original).
[80] ibid, para 335.
[81] ibid, para 335.
[82] ibid, para 336.
[83] ibid, para 337.
[84] ibid, para 339.

tribunal held that while the BIT's purpose was to encourage investment, 'it would be a violation of all the canons of interpretation to pretend to use its objects and purposes … to nullify four explicit provisions.'[85] Thus, it concluded:

> Plainly, as indicated by these four provisions, economic transactions undertaken by a national of one of the parties to the BIT had to meet certain legal requirements of the host state in order to qualify as an 'investment' and fall under the Treaty.[86]

The tribunal added that while a government should be 'estopped from raising violations of its own law as a jurisdictional defense when it knowingly overlooked them and endorsed an investment which was not in compliance with its law,'[87] in this case, there was 'no indication in the record that the Republic of the Philippines knew, should have known or could have known of the covert arrangements which were not in accordance with Philippine law when Fraport first made its investment in 1999.'[88]

The tribunal then considered whether Fraport's investment was in accord with Philippine law. It concluded that 'Fraport from the outset understood, with precision, the Philippine legal prohibition' but 'proceeded with the investment by secretly violating Philippine law through the secret shareholder agreements.'[89] In this connection, the tribunal decided not to give weight to the decisions of certain Philippine institutions dismissing complaints that Fraport and PIATCO violated the Philippine Anti-Dummy Law principally because the tribunal concluded that those institutions had not been aware of the secret agreements that were at issue in the arbitration.[90] The tribunal also endorsed *Inceysa v El Salvador* in that 'holdings of municipal legal institutions cannot be binding with respect to matters properly within the jurisdiction of this Tribunal.'[91]

While the tribunal agreed that 'an investor is entitled to reasonable reliance upon the State's contemporaneous manifestations of its understanding of its laws,'[92] and that 'in some circumstances, the law in question of the host state may not be entirely clear and mistakes may be made in good faith,'[93] it found that the facts in the case precluded Fraport from relying on such presumptions.[94]

[85] ibid, para 340.
[86] ibid, para 340.
[87] ibid, para 346.
[88] ibid, para 347. See also ibid, at 386-388.
[89] ibid, para 355.
[90] ibid, paras 357-382.
[91] ibid, para 391.
[92] ibid, para 392.
[93] ibid, para 396.
[94] ibid, para 397.

The tribunal concluded that 'Fraport knowingly and intentionally circumvented the [Anti-Dummy Law] by means of secret shareholder agreements. As a consequence, it cannot claim to have made an investment 'in accordance with law'. … Because there is no 'investment in accordance with law', the Tribunal lacks jurisdiction *ratione materiae*.'[95] The tribunal dismissed the case accordingly.[96]

VI. Plama Consortium Ltd. v Bulgaria[97]

Plama Consortium Ltd. v Bulgaria involved claims submitted to ICSID arbitration under the Energy Charter Treaty (ECT)[98] by a Cypriot company that purchased shares in a Bulgarian company that owned an oil refinery.

The Bulgarian company had been subject to an earlier privatization and remained in a five-year post-privatization control period during which time the right to resell any of its shares was conditioned upon obtaining the approval of the Bulgarian Privatization Agency. Plama Consortium had obtained such an approval and accordingly concluded an agreement with the Privatization Agency to acquire the company's shares from another private entity, by substituting as a party to the original privatization agreement. The approval of the Privatization Agency was based upon Plama Consortium's representations that it was a consortium of two large and experienced international companies possessing the resources necessary to operate the refinery. Thereafter Plama Consortium completed the share purchase and took steps to operate the refinery. When the project later failed, however, Plama Consortium commenced ICSID arbitration.

During the course of the arbitration and in response to various jurisdictional objections that had been raised by Bulgaria, Plama Consortium advised that it was not a consortium of two large and experienced international companies, but rather was owned entirely by an individual French national, Mr. Vautrin. In response, Bulgaria objected to jurisdiction on the ground that Plama Consortium evidently had obtained the Privatization Agency's consent to acquire its investment by fraudulent misrepresentation. Bulgaria argued that, as such, the Privatization Agency's consent was null and void and, therefore, that the claimant did not own or lawfully control the investment (*i.e.*, the shares in the Bulgarian company).

[95] ibid, para 401. The tribunal also observed that while its decision did not rest on policy, '[r]espect for the integrity of the law of the host state is also a critical part of development and a concern of international investment law.' ibid, para 402.

[96] One of the arbitrators dissented, concluding, *inter alia*, that the Philippines failed to demonstrate a breach of the Anti-Dummy Law, and that 'the legality of the investor's conduct is a merits issue.' See Dissenting Opinion of Mr. Bernando M. Cremades dated 19 July 2007, paras 35, 38.

After reviewing the record evidence in a separate jurisdictional phase, the tribunal concluded that although the 'actual state of the Privatization Agency's consent under Bulgarian law and its effect on the Claimant's investment remains unclear to the Tribunal,' it could not admit that submission as a jurisdictional challenge 'so belatedly.'[99] Bulgaria maintained its jurisdictional objection as the case proceeded to the merits, but then also argued that, having obtained its investment via fraudulent misrepresentation, the claimant was not entitled to the substantive protections of the Energy Charter Treaty.

As to jurisdiction, the tribunal ultimately did not accept the argument that claimant's misrepresentation could support a jurisdictional objection. The tribunal did accept, however, that 'the matter concerns the question as to whether Claimant is entitled to the substantive protections offered by the ECT.'[100]

After evaluating the evidence on the issue, the tribunal found that the claimant 'represented to the Bulgarian Government that the investor was a consortium' of two major experienced companies, 'which was true during the early stages of negotiations.'[101] However, the two companies soon withdrew, and the claimant and Mr. Vautrin 'failed, deliberately, to inform Respondent of the change in circumstances, which the Tribunal considers would have been material to Respondent's decision to accept the investment.'[102] According to the tribunal, 'Bulgaria had no reason to suspect that the original composition of the consortium … had changed to an individual investor acting in the guise of that 'consortium', and no duty to ask.'[103] The tribunal concluded that the investment thus was 'the result of a deliberate concealment amounting to fraud, calculated to induce the Bulgarian authorities to authorize the transfer of shares to an entity that did not have the financial and managerial capacities required to resume operation of the Refinery.'[104]

The tribunal found that by doing so, the claimant carried out the negotiations with the Privatization Agency and executed its agreement

[97] *Plama Consortium Limited v Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award of 27 August 2008, *available at* http://ita.law.uvic.ca. Ms. Smutny served as counsel for Bulgaria in this case and Mr. Polášek as a member of Bulgaria's defense team.
[98] The claimant also presented claims under the Cyprus-Bulgaria bilateral investment treaty, but those claims were dismissed for lack of jurisdiction. *Plama Consortium Limited v Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction of 8 February 2005, *available at* http://icsid.worldbank.org.
[99] *Plama v Bulgaria*, Decision on Jurisdiction para 129.
[100] *Plama v Bulgaria*, Award para 112.
[101] ibid, para 134.
[102] ibid, para 134.
[103] ibid, para 134.
[104] ibid, para 135.

with the Agency 'in flagrant violation of … Bulgarian law,' in view of the Bulgarian legal obligation of good faith in negotiating and concluding contracts and the provisions regarding contracts obtained by fraud.[105]

The tribunal held that the protections of the ECT do not cover investments that are 'contrary to domestic or international law,' notwithstanding that the ECT does not expressly provide that investments must be made in conformity with a particular law.[106] The tribunal explained that this conclusion followed from the fact that the Energy Charter Treaty must be interpreted in accordance with the Vienna Convention on the Law of Treaties and from the fact that the introductory note to the ECT provides that its 'fundamental aim … is to strengthen the rule of law on energy issues.'[107] Consequently, the tribunal held, 'the ECT should be interpreted in a manner consistent with the aim of encouraging respect for the rule of law. The Arbitral Tribunal concludes that the substantive protections of the ECT cannot apply to investments that are made contrary to law.'[108]

The tribunal clarified that it found that the investment in this case violated 'not only Bulgarian law,' but also applicable rules of international law, noting Article 26(6) of the Energy Charter Treaty, which provides that disputes were to be decided in accordance with 'applicable rules and principles of international law.'[109]

Relying on *Inceysa v El Salvador* and *World Duty Free v Kenya*, the tribunal concluded that such applicable rules and principles of international law included the principle of good faith, the principle of *nemo auditur propriam turpitudinem allegans* (nobody can benefit from his own wrong), as well as the notion of international public policy. It held that 'granting the ECT's protections to Claimant's investment would be contrary to the principle *nemo auditur propriam turpitudinem allegans*,' and that it 'would also be contrary to the basic notion of international public policy – that a contract obtained by wrongful means (fraudulent misrepresentation) should not be enforced by a tribunal.'[110] The tribunal also held that the claimant's conduct was contrary to the principle of good faith both under Bulgarian and international law.[111] In this connection, the tribunal observed:

[105] ibid, paras 136, 137.
[106] ibid, para 138.
[107] ibid, paras 138, 139.
[108] ibid, para 139.
[109] ibid, para 140.
[110] ibid, para 143.
[111] ibid, para 144.

> The principle of good faith encompasses, *inter alia*, the obligation for the investor to provide the host State with relevant and material information concerning the investor and the investment. This obligation is particularly important when the information is necessary for obtaining the State's approval of the investment.[112]

The tribunal concluded that it 'cannot grant the substantive protections of the ECT' to the claimant and accordingly dismissed the case on that basis.[113]

VII. Phoenix Action v Czech Republic[114]

Phoenix Action v Czech Republic involved claims presented to ICSID arbitration by an Israeli company under the Czech-Israeli bilateral investment treaty.

The claimant Phoenix Action had purchased two Czech companies involved in the trade of ferroalloys. The claimant was ultimately owned by a former Czech national, Mr. Beňo, who had fled to Israel from police custody in the Czech Republic in which he was placed in connection with an investigation of alleged tax and customs duties evasion and fraud. At the time of the purchase, the two Czech companies were ultimately owned by Mr. Beňo's wife and daughter, and were inoperative: one was embroiled in a long-running litigation with a former Czech business partner regarding the ownership of certain other Czech companies, and the other was subject to a freeze of funds by the Czech authorities, who also had seized its business and accounting documents and had imposed various tax and customs assessments on it.[115]

Two months after it purchased the two Czech companies, Phoenix Action informed the Czech Republic of the existence of a dispute under the Czech-Israeli bilateral investment treaty, and shortly thereafter commenced ICSID arbitration.

Initially, Phoenix Action claimed that the Czech companies had assigned the claims against the Czech Republic to it.[116] Given the obvious flaws in that theory, including that the Czech companies could hardly have had claims arising under the Czech-Israeli BIT to assign, the claimant argued that its claims arose out of bad acts that allegedly occurred after its investment (*i.e.* purchase of the companies), such as the alleged

[112] ibid, para 144.
[113] ibid, paras 146, 325.
[114] See *Phoenix Action Ltd v Czech Republic*, ICSID Case No. ARB/06/5, Award of 15 April 2009, *available at* http://icsid.worldbank.org.
[115] ibid, paras 21-43.
[116] ibid, paras 2-9.

continuing failure of the Czech courts to resolve the Czech litigation, the alleged continuation of the freeze of company funds and seizure of company documents, and that one of the two companies allegedly was required to respond to tax and customs assessments without the benefit of the seized documents.[117]

The Czech Republic objected to jurisdiction on the ground that Phoenix Action was an '*ex post facto* creation of a sham Israeli entity created by a Czech fugitive from justice' simply for the purpose of creating a basis to convert an existing domestic dispute into an ICSID arbitration, that such action 'violated the principle of good faith, which applies to all bilateral investment treaties and the rights derived therefrom,' and that Phoenix Action's purchase of the Czech companies was not an 'investment' within the meaning of the ICSID Convention and the bilateral investment treaty.[118]

The tribunal accepted that the question presented was whether claimant had made an investment within the meaning of Article 25 of the ICSID Convention and the applicable bilateral investment treaty.

The tribunal held:

> The ICSID Convention/BIT system is not designed to protect economic transactions undertaken and performed with *the sole purpose* of taking advantage of the rights contained in such instruments, without any significant economic activity, which is the fundamental prerequisite of any investor's protection. Such transactions must be considered as an abuse of the system. The Tribunal is of the view that if the sole purpose of an economic transaction is to pursue an ICSID claim, without any intent to perform any economic activity in the host country, such transaction cannot be considered as a protected investment.[119]

The tribunal continued:

> The purpose of the international mechanism of protection of investment through ICSID arbitration cannot be to protect investments made in violation of the laws of the host State or investments not made in good faith, obtained for example through misrepresentations, concealments or corruption, or amounting to an abuse of the international ICSID arbitration system. In other words, the purpose of international protection is to protect legal and *bona fide* investments.[120]

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[117] ibid, paras 44-48.
[118] ibid, paras 34-35.
[119] ibid, para 93 (emphasis in original).
[120] ibid, para 100.

Although the Czech Republic did not claim that Phoenix Action's purchase of the Czech companies was effected in violation of Czech law, the tribunal observed that '[t]he core lesson is that the purpose of the international protection through ICSID arbitration cannot be granted to investments that are made contrary to law,'[121] and that '[t]here is no doubt that the requirement of the conformity with law is important in respect of the access to the substantive provisions on the protection of the investor under the BIT.'[122] In addition, the tribunal observed that while 'access can be denied through a decision on the merits,' if it is 'manifest that the investment has been performed in violation of the law, it is in line with judicial economy not to assert jurisdiction.'[123]

The tribunal also observed that '[t]he protection of international investment arbitration cannot be granted if such protection would run contrary to the general principles of international law, among which the principle of good faith is of utmost importance.'[124]

Noting that 'every rule of law includes an implied clause that it should not be abused,' it concluded that that principle applied to international treaties, including the ICSID Convention and investment protection treaties, as well.[125] With regard to the case at hand, the tribunal stated that it was 'concerned here with *the international principle of good faith as applied to the international arbitration mechanism of ICSID*,' and that 'the Tribunal has to prevent an abuse of the system of international investment protection under the ICSID Convention, in ensuring that only investments that are made in compliance with the international principle of good faith and do not attempt to misuse the system are protected.'[126]

Based on an analysis of the facts of the case, the tribunal concluded that:

> The evidence indeed shows that the Claimant made an 'investment' not for the purpose of engaging in economic activity, but for the sole purpose of bringing international litigation against the Czech Republic. This alleged investment was not made in order to engage in national economic activity, it was made solely for the purpose of getting involved with international legal activity. The unique goal of the 'investment' was to transform a pre-existing domestic dispute into an international

[121] ibid, para 102
[122] ibid, para 104. The Tribunal emphasized, in accord with *Plama v Bulgaria*, that in its view, 'the conformity of the establishment of the investment with the national laws – is implicit even when not expressly stated in the relevant BIT.' ibid, para 101.
[123] ibid, para 104.
[124] ibid, para 106.
[125] ibid, para 107.
[126] ibid, para 113 (emphasis in original).

> dispute subject to ICSID arbitration under a bilateral investment treaty. This kind of transaction is not a *bona fide* transaction and cannot be a protected investment under the ICSID system.[127]

The specific factors that led the tribunal to this conclusion included that (i) at the time of the investment, the Czech companies already were burdened with the civil litigation and tax and customs investigations at issue and all alleged damage to the Czech companies already had occurred;[128] (ii) the claimant's initial theory was that the Czech companies assigned their ICSID claims to the claimant;[129] (iii) the claimant notified the dispute under the Czech-Israeli BIT to the Czech Republic a mere two months after it acquired the two Czech companies, and before it even registered its ownership of the Czech companies;[130] (iv) all transfers of the Czech companies were done inside Mr. Beňo's immediate family;[131] (v) prior to and after its investment, the claimant apparently never planned or attempted to perform any economic activity in the Czech Republic.[132]

Concluding therefore that '[h]ere the '*bona fide*' test is applied to the abusive distortion of the requirements for jurisdiction,'[133] the tribunal held that 'the Claimant's purported investment does not qualify as a protected investment under the Washington Convention and the Israeli/Czech BIT.' The Tribunal accordingly dismissed the case for lack of jurisdiction.[134]

VIII. Conclusion

One may observe from the above that issues relating to the establishment of an investment may give rise to both jurisdictional objections and defenses on the merits, and also may give rise to issues under both the ICSID Convention and the investment treaty or contract at issue. The analysis in the cases to date has varied with the particular circumstances presented, as well as, inevitably, the manner in which the issues are framed by the parties in the case. What is evident from these decisions, however, is that there is no doubt that parties and tribunals may consider the manner and circumstances in which an investor establishes or acquires an investment as a threshold matter to inquire whether there is a basis to present claims against the State in international arbitration.

[127] ibid, para 142.
[128] ibid, para 136.
[129] ibid, para 137.
[130] ibid, para 138.
[131] ibid, para 139.
[132] ibid, para 140. One is tempted to add the fact of the claimant's wishful name itself.
[133] ibid, para 143. The tribunal also noted that outside the jurisdictional context, the test 'may also play its role when it comes to the analysis of the substantive protection for investment under international treaties, which is a matter for the merits.'
[134] ibid, para 145.

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Charlotte and Thomas were married in 1995 and have a daughter, Olivia. Thomas also has a son by his first marriage, Max.

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Jacques Werner is mainly acting as an international arbitrator in commercial and investment cases. He is the chairman of the Geneva Global Arbitration Forum, editor of the Journal of World Investment and Trade, and visiting professor at Hunan Normal University Law School, Changsha, China, and City University of Hong Kong.

Remembrances

Following the news of his accident, the internet discussion forum OGEMID: (Oil, Gas, Energy, Mining, Infrastructure and Investment Disputes) received hundreds of messages in an outpouring of shock, grief and anecdotal remembrances saluting the life of Thomas Wälde. Many of these showed the world-wide impact of his life in the legal community, while others showed the depth, breadth and multi-faceted qualities to Thomas Wälde, the person.

OGEMID and the senders of many of these messages have graciously permitted us to include them here.

Arif Hyder Ryder & Jacques Werner

I am deeply shocked by the passing away of Thomas. It seems incredible to me that a person with his vitality and intellectual dynamism can disappear this way, so suddenly, in the middle of his intense work. He was a great jurist, intelligent, erudite, imaginative; but mainly he was a great man, true friend of his friends, always ready to help and to teach. Law science, and more particularly the Law about International Investment Arbitration that he has contributed so intensively to its development, has suffered a great loss; and all we knew him we have lost a great friend.

Fernando de Trazegnies Granda.

I was shocked to learn of this tragic news. I still struggle to believe this has happened. I have learned a huge amount from Thomas – first from his writings then from our always stimulating and thought-provoking exchanges. He was remarkably generous in devoting time and energy to younger researchers like me. And he was genuinely passionate about rigorous analysis and open debate. We had different views on several issues yet his encouragement, suggestions and support helped me get my ideas out – and were instrumental to some of the achievements I am most proud of.

This is a huge loss.

Lorenzo Cotula

We lose a truly unique human being who blew away the cobwebs and the preconceptions. Nothing was accepted as a given. Every accepted truth was to be challenged. Thomas helped us to understand what we do in a context far wider than we ever imagined. Our minds were broadened by him in a debate he opened to everyone, irrespective of age, status or origin. The only criterion was to have the courage to debate with one of the sharpest minds I have ever met. May his spirit live on and continue to break down barriers.

Nigel Blackaby

I too was shocked and saddened by the news of Thomas' sudden and untimely passing. I have been struggling to find the right words to express my feelings and sense of disbelief ever since hearing the sad news this morning.

Thomas has been a good friend for over twenty years. I first met Thomas through a mutual friend when he was the UN interregional adviser on mineral law and living in New York. I worked with Thomas on several projects and then again when he was first starting to build the Centre for Petroleum and Mineral Law and Policy into the wonderful institution that it is today. I also had the pleasure of inviting Thomas to speak to two different Committees that I chaired at the New York City Bar Association. He was a wonderful speaker who conveyed his scholarship and enthusiasm with ease and grace. We have kept up a warm and personal correspondence and he will be sorely missed. He was truly a unique and wonderful person who enriched the lives of those who were fortunate enough to know him.

My condolences to his family and may he rest in peace.

Alan D. Berlin

Among the most outstanding qualities of Thomas was his refusal to accept 'established truth'. Throughout his career, from his research in Frankfurt, to his work at the UN, in Dundee and, now since some time, as the 'spiritus rector' of the OGEMID debates, he continuously challenged us to think about new issues or to look at the old issues from different angles; and he combined this challenge with a thorough knowledge and understanding of the substance matters of our debate, from arbitration to public international law and many other fields.

The international legal community owes him a great debt. We should honour his memory by keeping his spirit of creative questions and thoroughness in the search for the answers.

Michael E. Schneider

I am shocked to hear the news of Thomas' passing. He was an inquisitive mind, an outstanding scholar of astonishing range, a leader in our field, and a good friend.

Oscar M. Garibaldi

The shock is too big to express in words. He was the voice, and with this voice he encouraged other voices to join this 'invisible college'. He selflessly and generously guided, mentored, inspired so many of us; became our friend and adviser in our professional endeavors.

Last week he told me that he was putting the last touches to his contribution for the book I am editing. One of his last touches….all together. Who could ever guess?

So long Thomas, we will miss you but will do everything we can to keep your memory alive.

In these painful moments, may his family find some comfort in this outpouring sympathy and appreciation. My thoughts are with them.

Katia Yannaca-Small

Thomas had a mischievous sense of humour. His sense of fun and his inquisitiveness were irrepressable. The joy he took in his work was tangible. His appreciation of the importance of that work never became a perception of his own importance. As we all can attest, he took a deep and genuine interest in individuals, ideas and principles. Above all, Thomas lived life enthusiastically.

Robert Volterra

Thomas was one of the most generous and open individuals I have known throughout my professional life. He first contacted me in the early 1990s and since then inspired a continuing interest and study

in international law. He always encouraged me to write for fora such as ENARES and OGEMID which he had created – at the same time wondering why, as a female, did I write 'like a man'. It's a joke we can no longer share. We last met in London in March 2006, just a week after my mother died. Even in those circumstances, Thomas helped me to get back to work. Recently, our differences of opinion and the reactions to my own posts meant that I could no longer contribute to the fora. I regret that break with him.

Thomas' opinions were an inspiration to us all.

My sincerest condolences to all of Thomas' family. Rest in peace, dear friend.

Maria Kielmas

I gained a lot from Thomas as his student and as a human being. Since completing my studies with him, he has also shown me that, other than teacher he is also a father. I regret not having called him more often to say how grateful I am to him.

May the Almighty take Professor Wälde to his bossom for the kindness and knowledge he shared with so many.

Yakubu Belgore

Although I have not had the chance to meet Thomas in the flesh, our virtual relationship goes back more than a decade. He was a remarkable citizen of a greater international community, someone who embodied what economic science calls positive externalities and what humanists might call virtue. We are all diminished by his sudden passing.

Paul B. Stephan

Thomas and I had worked together and conspired on a number of projects over the years. My best memory is climbing with him for three hours up the mountain to the tea house on Lake Agnes near Lake Louise, Canada. Thomas recalled his days climbing hills and mountains in his youth near Heidelberg. The hike included the usual Thomas stream of consciousness discussion of everything under the sun – his family being a large part of that discussion. After the hike, Thomas was determined to find something involving bears for his children. We

found a large, full sized, stuffed grizzly bear in one of the local stores and we took his picture with it. Thomas made his best effort to look fiercer than the bear.

His last email to me on Friday was a response to my appeal for the FDI Moot (of which he was a founder), chiding me for not donating enough and committing to give more than whatever I came up with. His generosity was legion. Thomas was a great friend and colleague and he will be sorely missed.

Ian A. Laird

I hope I can bend the Chatham House Rules in order to pass along this memory.

In May of 2006, I was sitting beside Thomas at a small round-table discussion at Chatham House. I left the room at one point, and returned to find that Thomas's papers and file-folders had spilled over into my small bit of table space.

In a bid to reclaim this contested territory, I muttered that I seemed to have fallen victim to a 'creeping expropriation'.

Let history record that Thomas leaned in, and in a rather mischievous tone, quietly offered a reading of the police powers doctrine so expansive that it would warm the heart of any state's advocate.

Luke Eric Peterson

As a new academic I can myself testify to Thomas's remarkable openness and his dedication to his subject. In my own short time participating in OGEMID I've had the experience of Thomas arguing with me, encouraging me, voluntarily reading an 80 page article, putting me in contact with other people in the field, and responding to almost every post I made with a thought-provoking e-mail. While he undoubtedly knew he was respected, I hope he also knew how much it meant to those of us just starting out in the field that he would take such a genuine interest. I can without hesitation say that even in the short time I knew him he had a significant effect on me – both from his efforts and his example.

Tony Cole

As a young academic, I will always remember Professor Wälde's encouragement and kindness.

Lux perpetua luceat eis..

Valentina Sara Vadi

I, too, am reeling from the news. Few have touched so many in ways both big and small. Thomas's openness and generosity to all, and his conviction that knowledge is to be shared rather than hoarded, are gifts that he has given many of us. I join with others in wanting to honor him by maintaining and expanding the community he leaves behind.

Andrea K. Bjorklund

On a personal and professional level, the news is shattering. Thomas was one of several truly brilliant minds in this field, and no one was more generous, creative, or encouraging of all who wanted to enter the seemingly rarefied world of investor-state arbitration. Perhaps more than anyone, he opened and democratized this field for generations of practitioners and scholars. One of my favorite (non-legal) stories about Thomas involves his attendance at the wedding of a young colleague of ours. Concerned that the wedding seemed quite expensive, he quietly added a personal check for $5000 to the wedding gift he had brought. (I know this only because I am good friends with the groom.) Thomas was like that in all aspects of his life, intellectual and otherwise: always seeking to help, encourage, and engage, always jumping into the thick of things with boundless spontaneity, generosity, and enthusiasm.

Alex de Gramont

A spark has gone out of the community and, while there are other lights, we will be hard-pressed to find its equal in terms of generating dialogue, ideas, and interchange. A great loss.

Lucinda A. Low

Among the most outstanding qualities of Thomas was his refusal to accept 'established truth'. Throughout his career, from his research in Frankfurt, to his work at the UN, in Dundee and, now since some time, as the 'spiritus rector' of the OGEMID debates, he continuously

challenged us to think about new issues or to look at the old issues from different angles; and he combined this challenge with a through knowledge and understanding of the substance matters of our debate, from arbitration to public international law and many other fields.

The international legal community owes him a great debt. We should honour his memory by keeping his spirit of creative questions and thoroughness in the search for the answers.

Michael E. Schneider

For me – the same as for other TW's students at CEPMLP – even thinking about this tragic loss was – and actually still is – a terrible shock. As put by Mirian; to us Thomas was a great teacher, mentor, friend, confidant, father and big brother.

For more than five years I worked with Thomas closely as a PhD student, his Editorial Assistant for the time he was JENRL's Editor and finally his research associate, when he gave me the rare opportunity to see what legal work actually meant. The experience I gained from working with Thomas, changed my future professional life.

I remember, when I completed my PhD in 2006, my wife was in her last year of her PhD studies, and to afford staying in UK for another one year I was in desperate need for a job. As usual, Thomas was there for me to help; together with Philip, he helped me to get a part-time job in CEPMLP. He also engaged me in some mediation and arbitration projects and generously paid me more than I expected.

I am not that good at writing emotional words, however, to see how great Thomas was, I recommend we read Mirian Kachikwu's email once more.

Deepest condolences to his beloved family, particularly his wife Charlotte.

May his soul rest in perfect peace.

Firoozmand MahmoudReza

I cannot believe how this has happened. This reminds all of us that life is just an accident and could take us down at any moment. Unexpectedly and timely for Thomas's departure. He had so much to produce, share and care. I worked with him on many occasions from

my days at IEA, then OECD and now BG Group. He did put University of Dundee on the global radar in energy. He excelled in making OGEL a 'must' for most of us – a precious source of knowledge, networking and inspiration.

I salute his memory and extend heartfelt condolences to his family and friends.

Mehmet Ogutcu

It is a devastating tragedy. Prof. Wälde was a special person to me and to all his students. Through him we have known to view the world in a better way, to respect and tolerate each with our varied culture and backgrounds. I owe a lot to Prof. Wälde and fully support any action to observe the date in commemoration of his valuable contribution to all the student community and to all of us. I hope very soon his students and friends will come out with a meaningful action in this regard.

I would also like to offer my heart felt condolences to his family.

Elwaleed Elmalik

Thomas enriched our personal and professional lives.

Supasit and Ratana first met Thomas in Dundee. Hunt and I earlier during his UNDP days.

Especially greatful for the special mission he sent me on to Hanoi in 1989.

Last month in Edinburgh Ratana and I encouraged Thomas to think about a trek to Everest base camp in Nepal. Perhaps he is there now.

Near the end of October, my daughter Siri will leave a prayer flag (blessed in his memory at Thangboche monastery) on Kalapatar overlooking the Khumbu icefall.

Al, and Supasit, Ratana, Hunt, and his other friends in Thailand.

I find myself physically shaken by the news. His passing leaves us and our legal community so much the poorer. Thomas was a giant. His intellectual curiosity, breadth of expertise and his generous nurturing of so many of us, is unparalelled and likely will never be matched.

Something you may not know about Thomas – he had a strong interest in the environment and had taken many steps to make his own

home more energy efficient. Our common interest in the environment led to our exchange of views as what role the ECT could play in addressing climate change. Thomas was always immediately responsive, happy to read drafts of articles and, in fact, had just last week kindly agreed to write a preface to a chapter on the subject.

As noted by others – we owe it to him to maintain the high traffic and caliber of the e-mail exchanges he started. They are invaluable and our continuation of this extraordinary work can be part of his legacy. Other projects to commemorate him should be pursued. All of us who benefited from his insights and guidance owe it to him.

Our hearts go out to his loved ones at this sudden and tragic loss. May he rest in peace.

Edna R. Sussman

This is a terrible loss.

We will miss his wisdom, his intellectual curiosity, his generosity, his boundless energy, his enthusiasm and his wonderful sense of humor.

None of us can alone fill Thomas' shoes, but I hope that all of us together will continue the many projects he initiated and nurtured.

John C. Gault

I was deeply shocked and saddened to hear the untimely death of Professor Thomas Wälde, a great researcher, organizer, leader, teacher and most of all a very good human being. I know Thomas almost for the last twenty years. From the days I started working as a Junior Lawyer at the Ministry of Mines and Energy of Ethiopia. That time Thomas was working as the UN Inter Regional Adviser for Mining and Petroleum and he immensely contributed towards the preparation of the draft mining laws of Ethiopia which was finally promulgated as the law of the country in 1995.

Then I joined the CEPMLP in October 1990 and by some miraculous coincidence Thomas came to the center as executive director at the beginning of 1991. The eminent Professor Bentham was retiring at the end of the academic year which was June 1991 and Thomas was taking over the leadership where he immediately introduced a kind of seminars that required post graduate students to present the progress of their LLM

and PhD dissertation. The processes helped us to gather comments and ideas during our research. He even encouraged us to participate in other research net works. A case in point was the Mining and Environmental Research Net Work which was launched at University of Sussex by Professor Alyson Warhurst to promote best practice in relation with the Environmental Management of Mining. A friend of mine, Kashim Tumsha, and I attended the first net work conferences in Brighton and presented the outline of our papers to the conference and had a chance to receive comments form various eminent intellectuals and professors in the mining and petroleum sector.

Though I had a prominent lawyer (Mr. Brian Youngman) as my advisor during my research, Thomas was always there to help and provide some suggestion, piece of article from Australia, America, Africa or some where, you name it. If an interesting article passed his desk or heard about a research some where related to one of our friends work, there was no doubt that he will be contacted and given some advice to follow it up or read the article or call and contact the research coordinator. A note with a copy of an article or a journal at the documentation center with an arrow indicating the addressee was a common feature. His office was always open to any one who may need to solicit for advise, comment or a source that he might have come across, what ever, the only rule was ?do not go around the bush come to the point.?

Once we finished our courses and dissertation and graduated, he took the initiative to encouraging some of us to continue for our PhD and in fact it was not only encouragement that comes from him, he always took the initiative to find the funding for the programme. I was one of those who had this opportunity and unfortunately unable to use it. I promised to come back to Dundee and continue my study, but never made it back. Just for lack of a little bit of an effort. In that respect I some times feel that I let him down and in fact his passing away aggravated my feeling of guilt.

After I came back to Ethiopia, while I was working for the Ministry of Mines and Energy and later with my own legal practices, Thomas was always a call or a message away. He was always prompt and ready to share his opinion and idea without any reservation and with plenty of generosity.

Though I remained a passive participant of ENATRES discussion forum I always read his notes and comments and it was amazing the amount of energy and knowledge he exerted for the advancement of his profession, the energy and mining sector and the environment. I

am a living testimony for his interest in the environmental affairs of the world as he was the one who convinced me to drop my other topic and encouraged me to write my LLM dissertation on Mining and Environment.

The untimely passing of this great human being is really not only a loss to his loved ones, the CEPMLP, to his friend and colleagues or to the energy and mining sector but it is a great loss to the world.

Goodbye dear Professor, a mentor and a good friend and let God rest your sole in peace.

May God send solace and strength to his loved once, friends and colleagues.

Wonde G. Selassie

Professor Thomas Wälde's attention, generosity and free thinking, which he rained upon all, will never be forgotten. He enthralled with his infectious enthusiasm for all that is interesting and amusing in the world. He was quick to impart sage advice to his friends and students; and we are all enriched by it. He was a big man, both in his physique and in his speech. His shining limitless energy shone the brighter in the reflected light of his affable mischief.

We remember him best as a friend, and as a mentor. When he spoke his truth, it was loud, clear and amiable. It commanded attention. If his continental accent was not familiar to English speakers, the content of his ideas were compelling. His immense scholarly production was genius at work.

Being with him was an invigorating experience. His unyielding desire to further the boundaries of scholarly debate, and unflinching support of those that do so, was famous. But his responses to the occasional platitudinous or impertinent remark by anyone on his e-mail list services could be withering. He was an enemy of prejudice, and had little patience for views emanating from sloth or slipshod preparation.

Thomas was very proud of his OGEMID list service, his favourite virtual community. It brought him pleasure to see that network being used to enhance intellectual discourse in a pleasant and courteous manner. He did more than most to establish the international investment law community. He conceived, cherished and moderated OGEMID; that legacy will remain a pillar of the "invisible college" of international

lawyers. The torrent of remembrance messages on OGEMID and other e-mail list services he established demonstrate that in his death he managed to achieve that which he yearned for while alive: to have the "lurkers" speak on the network. Let us be sure that he is watching us and reading the e-mails too. From a good place.

Creative and enthusiastic as his moderation of e-mail lists were, Thomas' was a great and prolific writer. He was dedicated to the life, and the power, of the pen. Those of us that knew him were well aware that beneath his words gushed a perennial waterfall of ideas. He combined in his writings eclectic knowledge, deep insight and extended imagination; his characteristic verve and élan apparent. He was never a citation ideologue. His capacity for work was unmatched, his energy exceptional. As a parent and husband, his intellect and industry were such that in the thick of those myriad obligations, he undertook various initiatives and excelled them, receiving various awards and citations. He started his professional life at the United Nations and subsequent to his move into academia, he led the Center for Energy, Petroleum and Mineral Law and Policy and shaped it into one of the world's premier educational institutions. A visionary.

Thomas was dignified and had strong hands. He dressed carefully and judiciously. He liked good food, he liked red wine too. He laughed a lot. He engaged with the world and all that is in it; he loved gossip and his home in France. He was devoted to his wife, his children and all he called his students, and proud of them. He was attached to and respected his peers. He enjoyed flirting with the establishment, taking pride in joining a leading set of London barristers. He had a great capacity for friendship and was a steadfast friend. He was unstinting in his belief of the human capacity for profound progress, without hesitation firing off an e-mail from his hand-held communication device, transmitting an idea into the collection of human knowledge. But he was also attached to the simple pleasure that accompanies a good cup of tea while basking in the radiance of the afternoon sun.

Thomas Wälde suffered a tragic accident on Monday, October 13, 2008, making static his dynamic mortal light. He fell off a ladder he was climbing and died in his summer home in the South of France, his favourite environment on physical earth. Someone captured it earlier in tribute: falling down to go up to heaven; typical Thomas. During his lifetime, he invited some of his friends and mentees out to his home, to write, to taste wine, to walk the gardens and to achieve inner-fulfillment. Take a moment to recall the boundlessness of his zest and the warmth of his affection.

His bequeathal to all who inherit his spirit is a sense of purpose, of moral earnestness and of urgency, with which to enhance our time in this world. His belief that the law applies equally to public as to private conduct, that the judicial process for the protection of private interests is an expression of the moral nature of man, and that the sole legitimate purpose of organised society is the protection and amplification of human freedom, was not an academic conviction but native passion. Iridescent passion.

Dev Krishan