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1. Investment Treaty Tribunal Looks Under the Umbrella,
By Luke Eric Peterson

A recent decision by an ICSID arbitral tribunal has heartened both parties to the case - albeit for different reasons.

On January 29th, the tribunal stayed an arbitration proceeding involving the Swiss firm, Société Générale de Surveillance S.A, but at the same time adopted expansive interpretations of several common investment treaty provisions.

SGS, which specializes in verification, certification and inspections related to international trade, is seeking some 160 million US dollars in unpaid fees for services rendered to the Philippines Government from 1998 to 2000.

Following SGS's mounting of a claim under the Swiss-Philippines bilateral investment treaty, the presiding tribunal found jurisdiction to examine several alleged breaches of the treaty, however, a majority of the tribunal elected to stay its proceedings, on the grounds that the claim was not admissible. Instead, the tribunal instructed SGS and the Philippines Government to pursue either a negotiated settlement or a resolution in local courts.

The case hinged upon the majority view that the claim was primarily a contractual one centering upon a disagreement amongst the parties as to the precise amount to be paid by the Philippines to SGS. While the tribunal did note - in an important ruling - that the treaty was drafted in such a way as to accommodate the arbitration of simple contract disputes (as well as alleged breaches of the treaty rules arising out of such contract breaches) the tribunal also held that the investor was bound to proceed through the local Philippines courts because the relevant contract had specified this avenue as the exclusive forum for disputes relating to the contract. According to Judith Gill, a partner with the London offices of Allen Overy and co-counsel for the Philippines, "The effect of the tribunal's decision is that an investor pursuing a claim under a contract cannot cherry-pick certain obligations, such those to make payments, whilst seeking to ignore others, such as those agreeing to resolve disputes a certain way."

Philippines officials have hailed the ruling, with Justice Undersecretary A J Teehankee telling a Philippines news agency that "The decision of the ICSID tribunal is a victory for the respect due courts of local jurisdiction which were voluntarily chosen and selected by the parties, and vindicates the position of the Philippines in seeking a good faith review of the correct amount due to SGS."

Although SGS faces a return to negotiations or the local courts, counsel for SGS, John Savage, a Singapore-based partner with Shearman & Sterling, also expressed satisfaction with other portions of the tribunal's rulings in an interview with INVEST-SD News Bulletin. Among other things, Savage pointed to "the tribunal's confirmation that SGS' activities constituted an investment in the Philippines under the Swiss-Philippines BIT and the ICSID Convention."; this was significant given that SGS established a local office in the Philippines, but performed much of its services outside of the country. Savage also hailed the tribunal's important determination that a broadly-phrased dispute settlement clause - providing for settlement of "disputes with respect to investments" - could encompass not only alleged breaches of the treaty, but also of an investment contract.

Savage also pointed to the tribunal's "confirmation of the effectiveness of the umbrella clause" - a reference to a provision in the Swiss treaty which obliges a host government to observe any obligation it has entered into with respect to specific investments in its territory.

Indeed, the meaning of the so-called "umbrella" clause had been at the center of an earlier arbitration mounted by SGS against the Government of Pakistan at ICSID. In that arbitration, the investor had sought to construe a somewhat differently worded provision in the Swiss-Pakistani treaty as having "the effect of elevating a simple breach of contract

to a treaty claim under international law". However, in a decision on jurisdiction released on August of 2003, the tribunal rejected SGS's argument, professing doubts that such an "unqualified and sweeping" result was intended by the parties when they concluded the Swiss-Pakistani investment treaty.

But in SGS's more recent case against the Philippines the presiding tribunal took a different view - one which has left Mr. Savage "very satisfied". In last month's decision on jurisdiction, the tribunal rejected the "highly restrictive" reading adopted by the earlier tribunal in the arbitration against Pakistan. Instead, the SGS-Philippines tribunal held that the object and purpose of investment agreements - namely, to create and maintain favourable conditions for investors - dictated that tribunals should resolve uncertainties in a manner which favours the protection of covered investments.

Accordingly, the tribunal held that the treaty provision for host states to "observe any obligation it has assumed with regard to specific investments" could be construed so as to require a host government to perform any legal obligations which it may have entered into vis a vis a foreign investor - including contractual agreements.

Judith Gill, co-counsel for the Philippines, says that such a reading, of a heretofore little-noticed provision found in many BITs, will give some states cause for concern. She expresses skepticism that developing countries which have signed onto bilateral investment treaties have grasped the potential import of vaguely-worded undertakings which may be "tucked away in the back of an agreement". In Ms. Gill's view, governments in some cases are "somewhat surprised to learn of the significance" which foreign investors - and arbitrators - read into such provisions.

Despite the investor-friendly reading of the umbrella clause in the SGS-Philippines case, the Swiss firm will need to proceed through local channels for the time being. The tribunal has instructed the parties to negotiate or litigate a solution to the outstanding invoices and to report back every six months, beginning in July of this year, in order to apprise the tribunal of progress in the dispute.

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2. UNCTAD Adds to its Series on Issues in International Investment Agreements

The United Nations agency charge with exploring trade and development issues has released the latest editions in its popular series on issues in international investment agreements. The new monographs examine the two basic means of dispute settlement in so-called IIAs, investor-state and state-state processes.

Plans are afoot for further volumes on the following topics: transparency; international investment agreements: a glossary; incentives; competition and state contracts.

The latest papers on dispute settlement are available for free down-load on the website of the UN Conference on Trade and Development (UNCTAD) at:

Dispute Settlement: Investor-State (www.unctad.org/en/docs//iteiit30_en.pdf)
Dispute Settlement: State-State (www.unctad.org/en/docs//iteiit20031_en.pdf)

3. NY Times: Foreign Investors Souring on Ecuador's Oil Sector

A recent report in the New York Times chronicles the mounting frustration on the part of foreign oil companies operating in Ecuador. The Times notes that Ecuador's shifting policies on tax and royalties have annoyed foreign investors, scared away some of the biggest players in the industry, and led to litigation by several firms seeking rebates on value-added taxes which were assessed, reimbursed and then withdrawn again.

Several oil companies, including US-based Occidental and the Spanish firm Repsol, are known to have resorted to arbitration against Ecuador. Repsol mounted an arbitration claim at ICSID in late 2001; those proceedings were declared closed by the tribunal on December 23, 2003. As yet, no decision in that case has been made public. Meanwhile, Occidental has been reported to have launched treaty arbitration against Ecuador using the UNCITRAL rules of arbitration - but has refused comment on that claim.

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"Oil Companies find Ecuador Frustrating", By Juan Forero, The New York Times, available at: www.nytimes.com/2004/02/10/business/worldbusiness/10ecuador.html

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Negotiation Watch:
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4. Australia-US FTA Sets Precedent With Lack of Investor-State Dispute Mechanism, By Luke Eric Peterson

A recently-concluded US Free Trade Agreement with Australia sets a precedent by not including a mechanism permitting foreign investors to arbitrate against their host government in the event of an alleged breach of the agreement's investment rules.

Throughout the negotiations, Australia had insisted that it would not accede to the controversial investor-state dispute settlement mechanism, which permits foreign investors to by-pass local courts and take their disputes to an international tribunal selected by the investor and the host government.

In a fact sheet released following conclusion of the FTA negotiations, Australia's Department of Foreign Affairs and Trade noted that the decision to exclude an investor-state disputes mechanism reflected "the fact that both countries have robust, developed legal systems for resolving disputes between foreign investors and government" Historically, the investor-state mechanism has been included in investment treaties between developed countries and developing countries, however it was a center-piece of the North American Free Trade Agreement between the US, Canada and Mexico.

A text of the Australia-US FTA has yet to be released, but Australian officials have noted that the agreement's investment rules permit Australia to continue its practice of screening inward investment. In some instances the threshold for screening has been increased sharply - from 50 million to 800 million dollars (AUS) for most investments - but for sensitive sectors, including media, financial services and telecommunications, the threshold for review is set much lower.
Another issue which loomed large in the US-Australia negotiations had been US demands for roll-back of content rules and quotas in the cultural and audio-visual sectors. In the end, Australia has retained its 55% local content quota for traditional broadcasting, however it has agreed to more restrictive commitments with respect to internet broadcasting which will require new rules to be least trade restrictive.

Finally, the two parties appear to have reached some rapprochement on the contentious question of Australia's Pharmaceutical Benefits Scheme, which had threatened to be a deal-breaker for negotiators. The US-based pharmaceutical industry, along with the Bush Administration, has long criticized the widespread global practice of applying price-controls and government-negotiated discounts in an effort to keep a lid on pharmaceutical prices.
While, the Office of the US Trade Representative had been coy about its precise demands in the Australia negotiations - declining right up until the eleventh hour to spell out its negotiating proposals in this area - there had been no doubt that it sought to obtain a better deal for "innovative pharmaceuticals": a form of short-hand for new medicines which may be backed by hundreds of millions of dollars of research & development costs.

In a press release issued upon conclusion of the US-Australia negotiations, the US touted an agreement of the parties to bring greater transparency to the process under which Australia screens drugs for inclusion on its publicly-subsidized drugs scheme. The two parties also committed to negotiating an independent review process which will be available to US drug firms which have had their new drugs rejected by the Pharmaceutical Benefits Advisory Committee (PBAC) which oversees Australia's PBS. However, these developments have been criticized by a former member of the PBAC, Professor David Henry of Newcastle University Medical School, who notes that every aspect of the process was already open to public scrutiny. In comments reported in the Australian Financial Review, Henry also noted that spurned firms currently enjoy the ability to challenge decisions of the PBAC in Australian courts.

Judging by reports in the Australian press, one enduring source of friction between US and Australian officials seems to be the fact that schemes such as the PBS are geared towards assessing drugs for their cost-effectiveness and the extent to which they represent significant improvements upon existing (and oftentimes, less expensive) products on the market. These criteria are thought to sit less comfortably with US drug firms which have been criticized on occasion for focusing too much attention upon creating slightly different versions of existing best-selling drugs such as Viagra, Prozac and other blockbuster medications.

Until the official text of the Australia-US FTA is released, it remains unclear what sort of substantive legal provisions have been written into the investment (or other) provisions of the FTA for pharmaceutical industry investors.

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"Here's A Hard Pill To Swallow", By Brian Toohey, Australian Financial Review, Feb. 14, 2004

"Free Trade 'Down Under'", Fact-Sheet, Office of the US Trade Representative, February 8, 2004, available at: http://www.ustr.gov/releases/2004/02/2004-02-08-factsheet-

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Australian Government fact sheet on investment in US-Australia FTA, available at: http://www.dfat.gov.au/trade/negotiations/us_fta/outcomes/09_investment.html

Australian Government fact sheet on health in US-Australia FTA, available at: http://www.dfat.gov.au/trade/negotiations/us_fta/outcomes/10_health.html

5. Bush Admin Sets Process in Motion to Amend BITs with Eastern and Central Europe, By Luke Eric Peterson

The Bush administration has taken a key step towards amending its bilateral investment treaties with eight Eastern and Central European nations. On December 9, 2003 the administration forwarded a protocol to the US Senate which sets the stage for the renegotiation of the US BIT with Romania. The administration will forward the remaining protocols early this year.
As earlier reported in INVEST-SD News Bulletin, the European Commission had identified a number of concerns with the US investment treaties which had been concluded earlier with a host of countries which are now under consideration for accession to an expanded European Union. Six of these countries (the Czech Republic, Estonia, Latvia, Lithuania, Poland, and the Slovak Republic) are slated for accession to the EU on May 1. 2004, while Bulgaria and Romania are expected to join in 2007.

In a political understanding concluded last September, the EU, the US and the various accession candidates signaled their intent to amend the BITs. In the recent protocol forwarded to the US Senate, the Bush Administration notes that the legal move is a necessity if the US hopes to retain its BIT with Romania:
"Without it, the European Commission would likely require Romania to terminate its U.S. BIT upon accession because of existing and possible future incompatibilities between our current BIT and EU law."

Indeed, the European Commission had pushed for abrogation of the accession country BITs, but backed away from this demand when US officials showed a willingness to resolve concerns through a process of negotiation.
Among the changes which were agreed in last September's Memorandum of Understanding (MOU) are further exemptions to the treaty's provisions on national treatment and most-favored nation treatment, as well as new exceptions to treaty disciplines against the use of performance requirements.

In particular, the EU accession candidates will once again be permitted to introduce minimum national-content requirements and quotas in the audio-visual sector, as is common practice in a number of Western European nations, Canada and Australia. Notably, the parties failed to agree a solution to concerns voiced by the European Commission that the treaty provisions on transfers failed to accord flexibility to host

governments in the event of serious financial or balance-of-payments difficulties. While the parties committed to further consultations on this question, the MOU recognizes the US desire that any solution not disadvantage its own investors relative to other third-party investors investing in existing member-territories. In other words, the MOU seems to imply that the existing BITs of some member-states also fail to accord governments with the ability to use emergency safeguards on transfers of capital in the event of a serious financial crisis or balance-of-payments difficulty.

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INVEST-SD Bulletin is produced By Luke Eric Peterson in Boston, Massachusetts for IISD.

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