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Negotiation Watch:
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1. Clarification on Aboriginals and Canada's investment treaties

A story on Canada's new model foreign investment protection agreement (FIPA) appearing in the May 25th, 2004 edition of INVEST-SD News Bulletin reported that "one general exception which is notably absent from the model FIPA is a provision found in some earlier Canadian agreements which permitted preferential treatment for the Aboriginal peoples of Canada."

An official with International Trade Canada (ITCAN) has since informed INVEST-SD News Bulletin that the absence of this exception from the newly-released model treaty text, does not signal a departure from the department's past negotiating agenda, but rather a move to follow the drafting approach used in the North American Free Trade Agreement

(NAFTA). Future FIPAs will house general exceptions, such as those for aboriginal programmes or social services, in an annex to the agreement, rather than in the body of the agreement.

Notwithstanding this change of address, ITCAN wishes to underscore that it will continue to pursue investment treaty exceptions for measures designed to accord preferential treatment to Canada's aboriginal peoples.

Arbitration Watch:
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2. Methanex arbitration proceeding; Open to the Washington public

As noted in an earlier edition of INVEST-SD News Bulletin, the hearing on the merits in the NAFTA Chapter 11 arbitration between the United States government and the Canadian-based Methanex Corporation have been opened to the public.

The case, which has attracted the scrutiny of a number of environmental groups, centers upon a California ban on MTBE - a gasoline additive for which the Methanex company supplies a key ingredient, Methanol.

For more information about attending the hearings which continue this week and next, please see the following link:

http://www.worldbank.org/icsid/methanex-form.htm

3. Tribunal rejects Waste Management's NAFTA claims,
By Luke Eric Peterson

An arbitration tribunal has rejected a claim by US-based Waste Management Inc alleging breaches of the North American Free Trade Agreement (NAFTA) by Mexico.

In an award handed down on April 30, the tribunal ruled that Mexico had not violated the NAFTA's provisions on expropriation and minimum standards of treatment.

The dispute arose out of a contract awarded to the US firm to provide waste disposal and street cleaning services in the popular tourist resort of Acapulco. Waste Management's local subsidiary signed a concession agreement which stipulated that the city would pay a monthly

fee for certain basic services. The contract also provided incentives for the city to encourage local residents and businesses to avail themselves of Waste Management's services in the territory.

Although the tribunal noticed that Waste Management's local subsidiary encountered difficulties, including disappointing uptake of its services and a persistent failure of the local authorities to pay invoices for public services rendered, the tribunal held that the investor endured no wrongdoing which rose to the level of a breach of Mexico's treaty commitments.

Notably, Waste Management first turned to NAFTA arbitration in 1998, but its claim was dismissed by a tribunal on the grounds that the firm had failed to waive other litigation at the domestic level.

Following the conclusion of that local litigation, the US firm filed again for arbitration under the NAFTA in September of 2000, a process which culminated in the present award.

In its examination of the merits of Waste Management's claim, the tribunal noted that, in contrast to some bilateral investment treaties, the NAFTA contains no obligation for governments to live up to contractual commitments (sometimes known as an "umbrella clause").

Accordingly, Waste Management would need to establish more than a mere breach of contract; it would need to demonstrate that the contractual breaches rose to the level of a breach of a provision of the NAFTA.

The firm alleged that the actions of various levels of government amounted to breaches of the NAFTA obligation to accord fair and equitable treatment, and to provide compensation in the event of measures tantamount to expropriation.

However, although the tribunal sympathized with the situation that Waste Management soon found itself in Acapulco, it characterized the investment as one that was rapidly recognized to have been commercially non-viable. The tribunal noted that it was not the role of international law to provide redress for such ill-starred investments.

In particular, the tribunal held that the actions of the various levels of government did not rise to the level of a breach of the NAFTA - nor was there any grounds for finding a denial of justice by the Mexican authorities, such that the investor could have claimed that it had no effective local recourse for challenging alleged breaches of its contract.

Apart from its legal significance, the facts of the case appear to be in line with a number of other foreign investment disputes which trace their roots, in whole or in part, to a public unwillingness to adapt to the entrance of a foreign investor engaged in the provision of basic public services.

The tribunal in the Waste Management case noted that locals were unaccustomed to paying separately for waste disposal services, and that the company rapidly ran into difficulty in signing up a critical mass of customers. Moreover, the firm did itself no favours by adopting the clumsy and "rather heavy-handed approach" of threatening legal action against residents - who were under no legal obligation to purchase the firm's services, even if it enjoyed an exclusive claim sell services in the area.

The tribunal noted that the firm's tactics appear to have stiffened local opposition to the investment, no doubt contributing to the likelihood that an overly-optimistic business-plan would fail to live up to its promise.

4. ICSID Tribunal splits sharply over question of corporate nationality,

By Luke Eric Peterson

In a rare occurrence, the President of an investment treaty arbitration tribunal has dissented from a decision on jurisdiction handed down by two party-appointed arbitrators and has signaled a concern for the "integrity" of the International Centre for Settlement of Investment Disputes (ICSID) system.

At issue is an unusual dispute mounted under the Lithuania-Ukraine bilateral investment treaty, where a group of Ukrainian investors have incorporated a legal entity in Lithuania, and then used that entity to invest back into Ukraine - and thereby avail themselves of the protections promised to "Lithuanian" investors by Ukraine under the BIT.

(The tribunal noted that there was no suggestion that the Ukrainian investors had incorporated the firm, Tokio Tokeles, in Lithuania with the express purpose of exploiting that nation's BIT with Ukraine. Indeed, Tokio Tokeles had been established in Lithuania prior to the negotiation of the BIT).

What was made clear by the majority decision handed down on April 29 of this year, is that many investment treaties may be drafted so liberally as to permit investors of one country to incorporate in another country,

and for the newly-created entity to adopt the nationality of that new state. The nominally 'foreign' investor may then re-invest in their country of origin at some later date, and lay claim to the treaty rights that are offered by their country of origin to foreign nationals.

And thanks to the Lithuania-Ukraine BIT's loose criterion for classification as a Lithuanian-origin investor - "any entity established in the territory of the Republic of Lithuania in conformity with its law and regulations - a majority of the tribunal held that Tokio Tokeles, while 99% Ukrainian-owned, and 2/3rds Ukrainian-managed, had clearly met this simple nationality test.

In addition, the majority (consisting of Daniel Price and Prof. Piero Bernardini) rejected a request by Ukraine to look beyond the surface question of Tokio Tokeles' legal residence, and to pierce the corporate veil: by inquiring into the actual control and ownership of the firm.

Although the majority readily acknowledged that the ICSID system was set up for the resolution of "international" investment disputes, they noted that this did not preclude parties to the ICSID Convention from choosing to define nationality along looser lines, such as was the case in the Lithuania-Ukraine BIT.

(The tribunal added that some investment treaties set a higher hurdle by permitting a given host state to deny the treaty's benefits to an investor if it is actually controlled by investors of the host state, and the investors have "no substantial business activities" in the putative home state. Because Lithuania and the Ukraine neglected to impose such conditions, they ensured that Ukrainians could be readily transmogrified into Lithuanians for purposes of the treaty.)

However, the majority's analysis was rejected by the tribunal President, Professor Prosper Weil, who in a sharp dissenting opinion, argued that in the context of ICSID arbitration, the definition of corporate nationality could not be left solely to the discretion of the parties (in this case, Lithuania and Ukraine, who chose to set a low bar in their bilateral treaty).

Quoting from the World Bank report establishing the ICSID system, Professor Weil noted that the system had been "designed to facilitate the settlement of dispute between States and foreign investors" with the aim of "stimulating a larger flow of private international capital into those countries which wish to attract it."

Weil pointedly noted that fidelity to the object and purpose of the ICSID Convention would lead to the conclusion that "It is only

international investment that the Convention governs, that is to say, an investment implying a transborder flux of capital". (asterisks denote italics in original)

Accordingly, Weil dissented from the majority's determination that "the origin of the capital is not relevant", holding that the majority view "runs counter to the object and purpose of the whole ICSID system". Indeed, Weil added, "Contrary to what the Decision maintains, when it comes to ascertaining the *international* character of an investment, the origin of the capital *is* relevant, and even decisive."

Expressing concern for the very "integrity" of the ICSID system, Professor Weil concluded his dissenting opinion with a stark warning:

"To sum up: The ICSID mechanism and remedy are not meant for, and are not to be construed as, allowing - and even less encouraging - nationals of a State party to the ICSID Convention to use a foreign corporation, whether preexistent or created for that purpose, as a means of evading the jurisdiction of their domestic courts and the application of their national law. It is meant to protect - and thus encourage - *international* investment."

"It is regrettable, so it seems to me, to put the extraordinary success met by ICSID at risk by extending its scope and application beyond the limits so carefully assigned to it by the Convention. This might dissuade Governments either from adhering to the Convention or, if they have already adhered, from providing for ICSID arbitration in their future BITs or investment contracts."

The Tokio Tokeles arbitration will now proceed to a hearing on the merits.

Copies of the majority and minority opinion on jurisdiction are available on the ICSID website at:

http://www.worldbank.org/icsid/cases/awards.htm

5. IISD releases new report on investment agreements and sustainable development

A new report from the International Institute for Sustainable Development (publisher of the INVEST-SD News Bulletin) offers an overview of the features, as well as some of the shortcomings, of international investment agreements. The report, Investment and

Sustainable Development: A Guide to the Use and Potential of International Investment Agreements, argues that the agreements should be designed so as to promote sustainable development through foreign investment. Copies of the report are available in PDF-form for free download at the following link:

http://www.iisd.org/publications/publication.asp?pno=627

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