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Arbitration Watch:
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1. ICSID Secretariat floats proposals for reforms to investor-state arbitration,
By Luke Eric Peterson

The Secretariat of the Washington-based International Centre for Settlement of Investment Disputes (ICSID) released a discussion paper today setting forth a variety of proposed changes to its rules of arbitration. The Centre is soliciting public feedback and none of the proposals could be adopted without a decision by the Centre's Administrative Council (consisting of representatives from each of the 140 states to ratify the 1965 ICSID Convention).

The Centre, which handles a large volume of arbitrations arising out of international investment treaties, offers two distinct forms of arbitration. The first of these is for disputes where both parties are

party to ICSID's founding Convention (or in the case of investors, hail from a state which is party to the Convention). The second arbitration procedure, the so-called Additional Facility, was created for those cases where only one party is (or hails from) a member-state.

Among the major changes proposed in the discussion paper is a reform designed to create a single appeals mechanism for reviewing arbitral awards. The discussion paper notes that there is "clearly scope for inconsistencies to develop in the case law" handed down by arbitral tribunals, which sit only to hear a single case. ICSID's Secretariat observes that a single appellate body could help to ensure the coherence of decisions handed down by different arbitral tribunals.

Currently, awards are subject to very different forms of review, depending upon which of the two ICSID arbitration rules are chosen.

Cases under the Additional Facility may be challenged in the courts of the country where the arbitration was legally sited - and will be subject to review under domestic arbitration law. For example, several recent NAFTA disputes (Metalclad v. Mexico, Feldman v. Mexico and SD Myers v. Canada) have all landed in Canadian courts thanks to the fact that they were conducted under the Additional Facility rules, and one of the parties to the dispute elected to challenge the tribunal's final award in the courts of the country where the arbitrations were legally sited.

Meanwhile, arbitration under the regular ICSID rules are subject only to internal ICSID review, according to a special procedure for annulment of tribunal decisions.

However, a proposed appeals facility would consolidate the review of both types of ICSID arbitration under a single procedure, managed by ICSID. In addition, such an appeals mechanism might be made available for investor-state arbitrations conducted under non-ICSID rules, such as the popular UNCITRAL rules.

The discussion paper notes that an appeals mechanism has been contemplated in a number of recent treaties concluded by various governments (for eg the recent US-Central America Free Trade Agreement), but to date, none have acted to establish such a body. ICSID's Secretariat cautions that the elaboration of multiple appeal mechanisms might prove counter-productive, and that greater coherence and consistency might be achieved by setting up a single appeals mechanism under ICSID's auspices.

Investment treaties might be drafted so as to provide that all

challenges to arbitral decisions would be directed to this ICSID body. Likewise, existing treaties could be amended so as to provide for the same recourse.

The appellate facility contemplated in ICSID's discussion paper would consist of 15 members nominated by ICSID's Administrative Council, upon the recommendation of the Secretary-General.

According to ICSID's proposal, whenever an appeal were mounted, three panelists would be selected to preside over the appeal, with the power to review awards for errors in law, or serious factual errors, as well as pursuant to the five grounds for annulment which are set forth in Article 52 of the ICSID Convention.
(See: http://www.worldbank.org/icsid/basicdoc/partA-chap04.htm#s05)

Apart from a proposed appellate mechanism, ICSID's discussion paper also moots several other reforms of the ICSID arbitration procedures, including ones related to transparency, qualifications of arbitrators, provision for expanded training of developing country officials in relation to investment treaty arbitration, and several procedural changes which would permit tribunals to issue provisional measures and dismiss unmeritorious claims on a speedier basis.

With respect to transparency, the paper suggests that ICSID's rules might be changed so that where the two parties to an arbitration do not consent to the publication of the final award by ICSID, that the Secretariat would be required to publish legal extracts from that award on an expedited basis. Currently, ICSID's rules authorize - but do not oblige - the Secretariat to publish such extracts; while these extracts are often published, concerns have been voiced about the lack of timeliness of publication.

In addition, the discussion paper notes that two investment treaty arbitrations under the UNCITRAL rules have seen tribunals assert a "broad authority to accept and consider submissions from third parties". However, to date, ICSID tribunals have not generated similar precedents. In recognition that arbitral proceedings might be "strengthened" by the intervention of civil society groups, business organizations or other state-parties, the discussion paper proposes that the ICSID rules be amended so as to clarify "that the tribunals have the authority to accept and consider submissions from third parties."

As for transparency of arbitral proceedings - which has been a sore point for some interested non-parties to ongoing arbitrations, the paper notes that the arbitral rules could be amended so as to deny a single party the ability to veto a decision to open the proceedings to public

attendance. Currently, tribunals must obtain the consent of both parties before hearings may be conducted in public. While several ongoing arbitrations have seen both parties give that consent - Methanex v. United States, Thunderbird Gaming v. Mexico and UPS v. Canada - the overwhelming majority of investment treaty disputes occur in-camera.

Finally, the paper also proposes additional requirements that arbitrators not only attest to their lack of past or present relationships with the parties to a dispute, but that they also disclose "any circumstances likely to give rise to justifiable doubts as to the arbitrator's reliability for independent judgment".

ICSID is seeking comments on the proposals in its discussion paper. Copies of the discussion paper, along with further information about the procedure for submitting comments on its proposals, can be found on the Centre's website at: http://www.worldbank.org/icsid/improve-arb.htm

Those wishing to forward their comments to the editor of the INVEST-SD News Bulletin may do so by emailing them to lpeterson@iisd.ca A summary of public comments can be published in a subsequent issue of INVEST-SD News Bulletin.

2. BIT award against Russia being challenged in Swedish appeal court,
By Luke Eric Peterson

An investigation by INVEST-SD News Bulletin has found that Russia lost a $2.35 million dollar (US) investment treaty arbitration in the summer of 1998 and has since sought to annul the award in Swedish courts.

The award, which has not been published, but which is circulating amongst some international investment law practitioners, arose out of a claim by Mr. Franz Sedelmayer, a German national, under the 1989 Germany-Russia bilateral investment treaty.

During the early 1990s, Mr. Sedelmayer, operating through a wholly-owned US company SGC International, entered into partnership with the Leningrad (later St. Petersburg) police authority for the provision of law enforcement equipment, the establishment of training premises, and the creation of a private, armed security agency which would provide services to private individuals and institutions.

As part of the arrangement, the police authority arranged for the transfer of several St. Petersburg buildings for use by SGC International. However, SGC shortly found itself the subject of internal

court proceedings in Russia - challenging the manner in which the company was registered with the state and in which it had effected its capital contributions to the joint enterprise run with the St. Petersburg police authority.

And in December of 1994, then-President Boris Yeltsin, issued a Presidential Directive ordering that the buildings be transferred to a state agency for use in entertaining foreign delegations visiting Russia as guests of the President.

In January of 1996, Mr. Sedelmayer turned to arbitration under the Germany-Russia BIT, seeking compensation for lost use of the properties, as well as various other pieces of equipment (vehicles, uniforms, weapons, etc.) and items (paperwork, computers, etc.) related to his Russian business.

Sedelmayer's claim was heard before a tribunal consisting of three arbitrators at the Stockholm Arbitration Institute, and was chaired by Swedish Supreme Court Justice Staffan Magnusson. Professor Ivan S. Zykin and Jan Peter Wachler, were the appointed arbitrators of Russia and Mr. Sedelmayer respectively.

In an award handed down on July 7, 1998, two of the three tribunal members ruled that Mr. Sedelmayer had been the victim of an expropriation under the terms of the BIT and ordered compensation.

Enforcement of the award was suspended by the Stockholm District Court later that year, upon request of the Russian Federation - which turned to the court in an effort to have the award declared null and void. However, in a decision rendered on December 18, 2002, the Court dismissed Russia's request, leading the Federation to turn to the Svea Court of Appeal in a further effort to challenge the award.

According to informed sources, the latter proceeding is still under way.

The Sedelmayer arbitration grappled with an issue of some public interest in an era of globalization: whether a German businessperson could invest in Russia via subsidiaries based in third countries (set up in order to minimize tax liabilities in Germany), yet still invoke the protection of Germany's bilateral investment treaties upon running into difficulty abroad.

A majority of the tribunal was of the view that Mr. Sedelmayer could bring a claim under the German-Russian BIT in relation to SGC International's business arrangements in Russia, notwithstanding the fact that SGC was a US-registered firm. (The US firm could not pursue

its own international claim against Russia under a treaty because the US-Russia BIT, while signed in 1992, never came into legal force).

A witness testifying on behalf of the Russian Federation told the tribunal that some international investment treaties contain express language which provides for the use of the so-called control theory, so that tribunals might be able to pierce the veil of a corporate entity and inquire into who retains ultimate control of the entity.

A majority of the Sedelmayer tribunal acknowledged that the Germany-Russia BIT contained no clause providing for the application of such a test, however it added that "there is nothing in the Treaty which excludes the applicability of said theory."

Notwithstanding the absence of a provision mandating the piercing of the US corporate veil, the tribunal pointed to two factors which gravitated towards a decision to do so.

First, it noted that the treaty contained a protocol which protected an investor in the case of interference "with the economic activities of an enterprise in which he is participating." The tribunal interpreted this as an invitation to protect the rights of investors who might be investing via vehicles incorporated in third-countries.

Second, the tribunal noted that it was bound to interpret the treaty in line with its purpose, and it held that purpose to be the promotion of "investments in the two countries (Russia and Germany) concerned."

This characterization of the treaty purpose is noteworthy, however, as it appears to take a generous view of the treaty preamble's declaration that Russia and Germany "endeavour to create conditions favorable to investments by each party in the territory of the other" The treaty preamble does not indicate whether the parties desire to create conditions for investments to enter their territories under the flag of a third-country. Nor does it indicate whether the parties wish to encourage those forms of outward investment which are structured so as to minimize tax revenues accruing to the nominal home state.

Indeed, not all members of the Sedelmayer tribunal were of the view that Mr. Sedelmayer's investments in the US company enjoyed the protection of the Germany-Russia BIT.

Arbitrator Ivan S. Zykin, in a dissenting opinion, warned that such interpretive leniency could lead to "considerable practical difficulties", and expressed little sympathy for Mr. Sedelmayer's decision to invest under an American flag, rather than the German one:

"The claimant could have made investments personally or through a German company, but, instead, he preferred to act, as explained, for tax reasons through a company of a third state. It seems unlikely that the purpose of the 1989 Treaty between Russia and Germany was to encourage such kind of investments and to offer them protection."

As noted above, the Svea Court of Appeals is now reviewing the tribunal's award. When a decision is rendered, INVEST-SD News Bulletin will endeavour to obtain a copy and report on the Court's ruling.

A copy of the Stockholm arbitration tribunal's award can be obtained here:

http://www.iisd.org/pdf/2004/investment_sedelmayer_v_ru.pdf

Negotiation Watch:
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3. EU-Mercosur talks put on backburner til next year,
By Luke Eric Peterson

In a joint announcement last week, the European Union and Mercosur (Brazil, Uruguay, Paraguay and Argentina) confirmed that talks on a free trade agreement have missed an October 31st deadline for conclusion.

Following a last-ditch meeting in Lisbon last week, the two sides announced that differences were still too wide between the parties. Talks, which were launched in June of 2000, are slated to resume again in 2005 once a new European Commission has been sworn in as the executive body of the EU.

Published reports suggest that EU offers on agricultural liberalization have been viewed as inadequate by Mercosur negotiators, while the EU continues to push for better offers on government procurement, investment and services, having rejecting an improved Mercosur offer tabled in May of this year.

Sources:

"EU-Mercosur Free trade talks extended into 2005", Agence France Presse, Oct. 20, 2004

"European Union, Mercosur make no progress on free trade deal",

Associated Press, Oct. 20, 2004

Info on EU-Mercosur Relations and Negotiations, available on EU website at:
http://europa.eu.int/comm/trade/issues/bilateral/regions/mercosur/index_en.htm

4. Transparency International releases annual index on perception of corruption

Transparency International, a Berlin-based NGO, last week issued its Corruption Perceptions Index 2004.

The annual survey summarizes the findings of a dozen different surveys which polled business persons and country analysts on their perceptions of public sector corruption in 146 different countries.

While the survey ranks countries relative to one another, Transparency International stresses that attention should be paid to a given country's score over time. Indeed, the organization warns that decisions over aid and investment should take into account whether a country's own score is improving year-on-year - even if it still remains near the bottom of the global rankings.

By this measure, TI hails certain developing countries and economies in transition for improvements, including El Salvador, Botswana, Czech Republic, Gambia, Jordan, Tanzania, Thailand, Uganda, Uruguay and the United Arab Emirates.

In a press release issued last week, TI noted that corruption remains a particular problem in a number of major oil-producing states, including Angola, Azerbaijan, Chad, Ecuador, Indonesia, Iran, Iraq, Kazakhstan, Libya, Nigeria, Russia, Sudan, Venezuela and Yemen. "In these countries, public contracting in the oil sector is plagued by revenues vanishing into the pockets of western oil executives, middlemen, and local officials," noted the report's authors.

Transparency International calls for western governments to pressure oil companies into publishing details of fees and royalties paid to host governments and state oil companies, so that those revenues - and their uses - may be tracked.

In particular, TI notes that transparency needs to be a central feature of the Iraqi oil sector. Peter Eigen, Chairman of Transparency

International, said, "The urgent need to fund postwar construction heightens the importance of stringent transparency requirements in all procurement contracts. Without strict anti-bribery measures, the reconstruction of Iraq will be wrecked by a wasteful diversion of resources to corrupt elites."

Sources:

"Corruption is rampant in 60 countries, and the public sector is plagued by bribery, says TI", Transparency International Press Release, Oct 20, 2004, available at: http://www.transparency.org/pressreleases_archive/2004/2004.10.20.cpi.en.html

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