Investment Treaty News (ITN), December 19, 2006

Published by the International Institute for Sustainable Development
(http://www.iisd.org/investment/itn)

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Editor's Note:

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1. Reader Survey Reminder

Dear ITN Readers,

If you have not already done so, please take a few minutes to fill out our on-line reader survey. Your feedback and comments are very important to us, and guide our efforts to provide a useful public service. You can find the (very brief) survey here:

http://www.surveymonkey.com/s.asp?u=80012884234

Wishing you a Happy New Year,
Luke Eric Peterson

Arbitration Watch:
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2. Tribunal declines jurisdiction over fraudulently made investment in El Salvador,
By Luke Eric Peterson

An arbitral award rendered by a tribunal in a notable dispute between a Spanish enterprise and the Government of El Salvador has been released to the public.

In the award, dated August 2, 2006, and released to the public in late November, a three member tribunal at the International Centre for Settlement of Investment Disputes (ICSID) declined jurisdiction over the case of Inceysa Vallisoletana S.L. v. Republic of El Salvador.

The claimant turned to arbitration in 2003, alleging that El Salvador had breached the terms of a contract which entitled the Spanish firm to establish motor vehicle inspection facilities throughout the Central American country and to conduct physical inspections and emissions-control testing.

In addition to its contractual claim, the Spanish firm also charged that El Salvador had breached the terms of a bilateral investment treaty in place between the two countries.

The Government of El Salvador countered that the investor had made various misrepresentations in the course of securing a contract from the El Salvador Ministry of the Environment. As a consequence of this, El Salvador contended that Inceysa's investment had been made illegally, and could not be arbitrated pursuant to the Spain-El Salvador BIT.

In an effort to buttress its argument, El Salvador pointed to a provision of the investment treaty which stipulates that covered investments must have been made in accordance with El Salvador's laws.

El Salvador also insisted that the non-treaty claims (e.g. for breach of contract) were also outside of the jurisdiction of the tribunal, because the Government had not consented to ICSID arbitration of disputes arising out of investments obtained through fraudulent means.

Much hinged, therefore, upon the tribunal's finding as to whether the Spanish investors had secured its investment through fraudulent means. Ultimately, the tribunal would concur with El Salvador in finding that Inceysa had submitted false financial statements and forged documents to El Salvador authorities. Moreover, the tribunal found that

Inceysa had misrepresented its experience in the field of vehicle inspections – having embellished its own record during the public bidding process, when, in fact, the company's previous stock-in-trade had been the selling of women's underwear and shoes.

Concluding that the Spanish firm had engaged in "deceit" and misrepresentation in order to procure its contract with El Salvador, the ICSID tribunal was asked by El Salvador to determine whether this ought to be fatal to the investor's arbitration bid.

For its part, El Salvador argued that its consent to arbitration in the Spain-El Salvador BIT was limited to disputes which had been made in accordance with the laws of El Salvador.

The tribunal turned to examine the provisions of the relevant investment treaty, including two separate references to the need for covered investments to have been made in accordance with the laws of the host country. The tribunal also consulted the written records of the treaty negotiation between Spain and El Salvador, which shed further light on the intentions of the two countries.

Ultimately, the arbitrators took the view that "any investment made against the laws of El Salvador is outside the protection of the Agreement and, therefore, from the competence of the arbitral tribunal."

Thus, the tribunal turned to examine whether the misrepresentations by the Spanish investor were sufficient to render those investments illegal, and, as such, outside the coverage of the Spain-El Salvador treaty.

The tribunal began by looking at the BIT itself, which was, according to El Salvador's Constitution, considered part of that country's domestic law. Although the treaty itself was silent as to what would or would not constitute an investment made in accordance with the law.

The next port of call, therefore, was to turn to the "generally recognized rules and principles of international law" which had been referred to in the Spain-El Salvador treaty. Ultimately, the tribunal would identify a handful of such general principles, including good faith, "international public policy", the prohibition of unlawful enrichment, and a series of maxims which stipulated that no one should profit from their own fraud.

In each instance, the tribunal would hold that Inceysa's actions clearly ran counter to these general principles, leading to the conclusion that an illegally-made investment could not benefit from the protections of the Spain-El Salvador treaty.

Inceysa's parallel effort to convince the tribunal to take jurisdiction over alleged contractual (rather than treaty) breaches would prove no more successful. The tribunal examined a series of legal instruments, including El Salvador's Foreign Investment Law, and in each instance concluded that these instruments did not provide for jurisdiction

over disputes involving an illegally-obtained investment.

Notably, the tribunal would order the Spanish investor to bear all of the costs of the ICSID proceeding (e.g. arbitrator fees, ICSID expenses, etc.); however each party was left to pay its own costs for legal representation in the arbitration. The tribunal noted, without elaboration, that the conduct of El Salvadorian officials in the tendering process, and in the subsequent reaction to the actions of Inceysa, had not been beyond reproach.

3. Greek investor sues over mining operation in first known BIT case against Serbia,
By Damon Vis-Dunbar

An Investment Treaty News investigation reveals that the Greek industrial company Mytilineos Holdings is locked in an ad-hoc arbitration with the Republic of Serbia over an investment in a mining complex in the former Yugoslavia.

A knowledgeable source tells ITN that this is the only investor-state dispute under a bilateral investment treaty in which Serbia is currently involved – and is believed to be the first such BIT case brought against the country.

Mytilineos entered into a 7-year partnership agreement in 1998 with the state-owned copper mining and metallurgical group RTB-Bor, part of a mining complex that was the former Yugoslavia's single largest employer.

Under the terms of the agreement, Mytilineos provided the mining operation with capital, spare parts for machinery, and a commitment to purchase much of its production of copper, gold and silver. The agreement also granted privileged rights to obtain equity stakes in RTB-Bor in the event that it was privatized.

However, the partnership fell apart in 2001 when RTB-Bor declared insolvency, leading to a protracted dispute over outstanding debt owed to Mytilineos.

Mytilineos maintains that it was owed some US$25 Million when RTB-Bor collapsed. That debt was protected by guarantees from a state-owned bank which also declared bankruptcy; an act that Mytilineos maintains was intentionally orchestrated by the Serbian government to avoid payment of the debt.

Mytilineos responded by initiating arbitration for breach of the Greek-Serbia bilateral investment treaty at the Permanent Court of Arbitration in the Hague. Proceedings began in 2005, and a decision on jurisdiction in favour of Mytilineos was handed down earlier this year. That ruling has not been made public.

Another investment made by Mytilineos in northern Kosovo's Trepca mining complex also ended badly during the same period as the RTB-Bor partnership. In 1999, Mytilineos cancelled a five-year agreement, accusing its counter-parties of breaching their contractual obligations. Like the RTB-Bor investment, Mytilineos' investment in Trepca

was protected by letters of guarantee from a state-owned bank. When the bank failed to make the payment, Mytilineos initiated a challenge in Belgrade courts. In 2000, the company was awarded some US$50 Million.

Sources:

ITN reporting

4. US makes last-minute filing in arbitration between Texan farmers and Mexico,
By Fernando Cabrera Diaz and Luke Eric Peterson

As jurisdictional hearings came to a close last month in the NAFTA Chapter 11 dispute between Bayview Irrigation District, et al and the Government of Mexico, the U.S. State Department persuaded the presiding tribunal to accept a last-minute legal brief from the US Government.

The submission, filed November 27, came some months after the Tribunal had given the NAFTA Parties the opportunity to make submissions, leading to some publicly-expressed consternation on the part of the claimants.

As reported earlier by Investment Treaty News (ITN), the Bayview Irrigation dispute arises out of claims made by so-called Texas water districts and private individuals, that Mexico has failed to live up to its commitments under a 1944 water treaty signed with the U.S.

In their request for arbitration, the Claimants contend that Mexico diverted water from the Rio Grande River for the use of its own citizens, in a manner contrary to its obligations under the 1944 treaty (see "US water rights-holders sue Mexico under NAFTA", http://www.iisd.org/pdf/2004/investment_investsd_sept8_2004.pdf)

The Rio Grande divides Mexico and Texas forming part of the international border between the United States and Mexico. The river drains mostly from the Mexican side but its waters are owned by both countries and divided under the 1944 treaty.

Under the 1944 treaty, both sides are entitled to certain amounts of water that differ depending on the source of the water (i.e. the tributary or stage of the river from which it is derived).

An alleged period of drought in Mexico - which the government says began in 1992 - gave rise to the present NAFTA Chapter 11 dispute. Mexico has been unable or - according to the Claimants - unwilling to allow adequate amounts of water to flow to farms on the Texas side. The claimants allege that Mexico has used its reservoirs and dams to divert flows to Mexico's own farmers instead. According to the claimants this has resulted in as much as a billion dollars worth of losses to the affected Texas counties,

due to the resulting shortages of water to irrigate crops in that area.

The claimants allege that Mexico has violated protections accorded to foreign investors and foreign investments under NAFTA's Chapter 11.

For its part, the Mexican Government has objected to the NAFTA tribunal's jurisdiction on several grounds.

In its memorial on jurisdiction filed last April, Mexico points out that the 1944 water treaty has its own dispute resolution mechanism that may be invoked only by a state party to that agreement (i.e. Mexico or the United States). As such, Mexico argues that even if a breach of the 1944 water treaty could be construed as a breach of the NAFTA, it would be outside the competence of a tribunal formed under the NAFTA to decide whether such a breach had in fact occurred.

However, Mexico's primary argument against the tribunal's jurisdiction is that none of the Claimants have investments in Mexico and therefore cannot take advantage of the NAFTA's Chapter Eleven on Investment.

The Mexican Government argues that "Chapter Eleven in particular, only applies to investments of investors of a Party in the territory of another Party, and to the investors of another Party insofar and they have made such investments." On Mexico's reading, US citizens with no cross-border investments in Mexico ought not to be permitted to bring a NAFTA Chapter 11 claim.

The US-based claimants counter that Article 1101(1) (a) on the Scope and Coverage of Chapter Eleven gives the Tribunal jurisdiction to hear the dispute because that provision states that the chapter applies to measures adopted by a Party relating to investors of another Party, without mentioning any requirement for an actual cross-border investment. Similarly, according to the Claimants, Articles 1102 on national treatment and 1105 on fair and equitable treatment do not require cross-border investments.

(The claimants also insist, in the alternative, that they do indeed have a cross-border investment covered by NAFTA – namely property rights in certain Rio Grande waters located in Mexico. For its part, Mexico strongly disputes this assertion; insisting that US-granted rights to waters drawn from the Rio Grande River do not constitute property rights or investments in Mexico for purposes of NAFTA Chapter 11.)

A hearing on jurisdiction was held on November 15 and 16 in Washington D.C. at the International Centre for Settlement of Investment Disputes (ICSID). Nancie Marzulla, counsel for the claimants, tells ITN that it was late on the last day of the hearings that the United States Government approached the Tribunal in order to be allowed to make a submission.

Mrs. Marzulla says that the Claimants objected to this U.S. request, arguing that the Tribunal had established deadlines for any of the interested NAFTA Parties to file

submissions, and that the U.S. and Canada had declined to do so within these deadlines. Mexico, on the other hand, strongly supported the U.S. request and, in the end, the Tribunal agreed to let the U.S. make a written submission on a narrow question of interpretation of the NAFTA.

In that filing, the U.S. stressed that it was taking no position on the facts of the arbitration against Mexico, but sought to clarify one important point under consideration by the tribunal. The U.S. filing argues that Chapter 11, particularly Articles 1102 and 1105 requires that investors of one Party make investments in the territory of another Party.

The U.S. focuses its arguments on Article 1101(b) in the Scope and Coverage section of Chapter Eleven which states that the chapter applies to measures taken by a Party affecting the investments made by an investor of another Party in the territory of the first Party. On the US view, this article must be read as a requirement of any “investments” mentioned in Articles 1102 and 1105.

One implication of this argument would be that nationals in Country A could not seek to claim NAFTA Chapter 11 protections from Country B, unless those nationals had investments in the territory of Country B.

The US argument is potentially relevant to investor-state disputes where the claimant-investors are seeking protection for “investments” which are held largely outside of the nominal “host” country. For instance, one Chapter 11 arbitration recently filed against the US Government has been brought on behalf of Canadian cattle farmers who object to US restrictions on live cattle imports.

A key question to be explored in that arbitration may be whether the claimants need to have investments in the territory of the United States, or whether by virtue of their raising cattle in Canada for trade on an “integrated” North American market, they can qualify for protection under NAFTA’s investment chapter.

In the US filing dated November 27th, 2006, lawyers for the US State Department argue:

"To conclude that NAFTA Chapter Eleven extends substantive protections and the right to arbitrate to investors of a NAFTA Party that are not seeking to make or have not made investments in the territory of the NAFTA Party whose measure is at issue would constitute a radical expansion of the rights that each of the NAFTA Parties has granted to foreign investors under their BITs and under all other international agreements into which they have entered."

"Any such interpretation would render every person or enterprise in a NAFTA Party that believes that its business, wherever located, has been adversely affected by a measure of another NAFTA Party an investor entitled to Chapter Eleven’s protections. Such a result would also circumvent the mechanism provided in NAFTA Chapter Twenty for the resolution of purely trade-related disputes through State-to-State dispute settlement procedures."

A decision on jurisdiction in the Bayview v. Mexico arbitration is expected to be rendered sometime in 2007. If the Tribunal rejects Mexico's objections to its jurisdiction, the case will proceed to the merits phase.

Sources:

ITN interview.

Documents filed in this dispute are available on the NAFTA Claims website maintained by Canadian lawyer Todd Weiler:
http://www.naftaclaims.com/texas_water_claims.ht

U.S. State Department's submission and letter from Texas Agriculture Commissioner available on ITN's online document database:
http://www.iisd.org/investment/itn/documents.asp

5. Tribunal still deliberating in NAFTA dispute brought by UPS against Canada,
By Fernando Cabrera Diaz

This week marks the one year anniversary since an arbitral Tribunal began its deliberations in a high-profile NAFTA Chapter 11 dispute brought by U.S. firm United Parcel Services (UPS) against the Government of Canada.

UPS alleges that Canada has allowed the Canada Post Corporation to engage in unfair competition by exploiting its letter mail monopoly, in violation of the NAFTA national treatment obligations owed to foreign investors.

At issue is whether Canada Post has used its letter mail monopoly and other privileges granted to it by the Government of Canada to gain an unfair advantage in the highly competitive express courier market.

UPS argues that Canada Post has been granted privileges such as the exclusive right of collecting and transmitting first class mail, the power to prescribe rates of postage, the exclusive right to place its mailboxes in any public places free of charge, and exemptions from customs procedures applicable to other companies.

UPS alleges that these and other privileges have allowed Canada Post to maintain a vast network for the collection and delivery of postal services. The company argues that the privileges were granted to Canada Post so that it could supply basic postal service, but that it is using this vast network and privileges to unfairly compete in the courier market.

This, according to UPS, puts Canada in violation of the NAFTA's Article 1102 national treatment provisions.

The Government of Canada has responded to UPS's claims by arguing that Canada Post and private couriers like UPS are not in "like circumstances" – the key test for purposes of "National Treatment" - and as a consequence, UPS may be treated differently by the Government without Canada falling in violation of NAFTA Article 1102. Specifically, Canada argues that Canada Post's Universal Service Obligations (USO) - its requirement to deliver letter mail to and from every address in Canada - sets it apart from private couriers.

According to the government, Canada Post has to provide some competitive services in order to fund its other universal service obligations.

The case has attracted the attention of several Canadian groups. The Canadian Union of Postal Workers and the Council of Canadians have filed amicus curiae briefs in the case, expressing concern that investor-state arbitration under NAFTA may be used to undermine universal public services such as postal service or health care.

Hearings on the merits in the UPS v. Canada case were held in December of 2005 at the World Bank's headquarters in Washington D.C. As reported previously in Investment Treaty News, the case is being administered by the International Centre for Settlement of Investment Disputes (ICSID), but is being governed by the UNCITRAL rules of arbitration (see "Business group, union, and NGO weigh in on UPS arbitration against Canada," http://www.iisd.org/pdf/2005/investment_investsd_nov21_2005.pdf).

An official at the Canadian Department of Foreign Affairs told Investment Treaty News that these case generally take anywhere from 6 to 18 months to be decided meaning a decision is likely early next year.

Sources:

ITN Interview.

Documents filed in this dispute can be found on the Canadian Department of Foreign Affairs website: http://www.dfait-maeci.gc.ca/tna-nac/disp/parcel_archive-en.asp

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Briefly Noted:
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6. New Book on Foreign Investment Protection in Developing Countries

Oxford University Press has just published a new work entitled "Making Foreign Investment Safe, Property Rights and National Sovereignty", By Louis T. Wells and

Rafiq Ahmed.

From the publisher's blurb:

"With real case stories, Wells and Ahmed bring to life both the hopes for and the failures of international guarantees of property rights for investors in the developing world. Their cases focus on infrastructure projects, but the lessons apply equally to many other investments. In the 1990's inexperienced firms from rich countries jumped directly into huge projects in some of the world's least developed countries. Their investments reflected almost unbridled enthusiasm for emerging markets and trust in new international guarantees. Yet within a few years the business pages of the world press were reporting an exploding number of serious disputes between foreign investors and governments. As the expected bonanzas proved elusive and the protections weaker than anticipated, many foreign investors became disenchanted with emerging markets. So bad were the outcomes in some cases that a few notable infrastructure firms came close to bankruptcy; several others hurriedly fled poor countries as projects soured."

"In this book, Louis Wells and Rafiq Ahmed show why disputes developed, point out how investments and disputes have changed over time, explore why various firms responded differently to crises, and question the basic wisdom of some of the enthusiasm for privatization. The authors tell how firms, countries, and multilateral development organizations can build a conflict-management system that balances the legitimate economic and social concerns of the host countries and those of investors. Without these changes, multinational corporations will lose profitable opportunities and poor countries will not gain the contributions that foreign investment can make toward alleviating poverty."

http://www.oup.com/us/catalog/general/subject/Economics/International/?view=usa&ci=9780195310627

7. Washington Conference on Energy Charter Treaty slated for May 2007

The Washington-based International Centre for Settlement of Investment Disputes will host a conference on May 18th, 2007, to discuss the Energy Charter Treaty. The conference is co-sponsored by the Energy Charter Secretariat, and the Arbitration Institute of the Stockholm Chamber of Commerce. Discussion is expected to touch upon various procedural and substantive issues related to arbitration under the ECT.

The ECT is a major multilateral trade and investment treaty governing the energy sector, and foreign investors enjoy the right to take governments to international arbitration over selected energy-related disputes. A number of arbitration claims have been launched under the ECT in recent years, with most presumed to be handled by the ICSID or the SCC Institute. However, a full accounting of these international cases is not available, as the ECT contains no requirement for investors or governments to publicly disclose such arbitrations.

Perhaps most notably, the majority shareholders in the embattled Yukos Oil company have invoked the ECT in a multi-billion dollar arbitration against the Russian Federation, in an ongoing effort to claim compensation for the alleged expropriation of the Yukos company. While Russia has not ratified the ECT, it did put its signature to the agreement – giving rise to a possible argument by foreign investors under Article 45(1) of the treaty that the Federation has committed to apply the treaty obligations on a "provisional" basis. As previously reported in ITN, an official with the Energy Charter Secretariat in Brussels concedes that "The manner and extent to which a state's acceptance of provisional application of a treaty creates legal obligations is not completely clear under international law". In recent months, Russia has come under sustained pressure from European Union countries to complete its ratification of the ECT. European governments have expressed concerns about energy security, as well as the legal security of foreign investments in Russia's energy sector.

For more information about the Washington conference visit:
http://www.worldbank.org/icsid/highlights/conf-flyer.pdf

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