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Arbitration Watch:
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1. Jurisdiction upheld in El Paso v. Argentina, as thorny interpretive issues explored,
By Luke Eric Peterson and Fernando Cabrera*

In a ruling handed down in April of this year, an ICSID tribunal affirmed its jurisdiction to hear a claim brought by El Paso Energy alleging breach by Argentina of the US-Argentina bilateral investment treaty.

The decision is notable for the tribunal's call for a more balanced approach to investment treaty interpretation, rejecting the view of earlier tribunals that uncertainties should be resolved either in favour of foreign investors or host states as a matter of default.

Equally noteworthy, the tribunal decision re-opens a debate over a series of vague treaty provisions which some have construed as so-called "umbrella clauses", obligations which could elevate ordinary breaches of contract by a state to a breach of international law.

The El Paso arbitration at ICSID was brought in relation to several ownership interests held by US-based El Paso in Argentine energy companies, including a stake in CAPSA, a company engaged in the exploration, development and production of oil, and CAPEX, a company in the energy generation business.

According to El Paso, the firm sold these and other of its interests for an estimated 10% of their original value, in the aftermath of the Argentine financial crisis. In common with a large number of foreign investors, El Paso attributes its losses to measures taken by Argentina to stem the crisis.

Specifically, the firm claims that it received assurances that Argentine laws and regulations would remain stable over the long term horizon. However, when Argentina was buffeted by crisis, the country withdrew the Energy Regulatory Framework under which energy companies like CAPSA and CAPEX had operated profitably throughout the nineties. El Paso also took issue with the cancellation of a policy which had pegged the Argentinean Peso to the US Dollar.

The firm filed its claim at ICSID in early 2003. Argentina raised several objections to ICSID's jurisdiction over the case. These objections were all dismissed in the tribunal's decision handed down on April 27, 2006.

In particular, the tribunal rejected Argentina's suggestion that a foreign investor must retain ownership of its investment in order to retain standing to continue its ICSID arbitration.

Of more note, however, the tribunal weighed into a debate over the appropriate posture of international tribunals when interpreting investment treaties. The tribunal composed of three European professors (Lucius Caflisch, Brigitte Stern and Piero Bernadini) took issue with earlier arbitral tribunals who have held that ambiguities in investment treaty terms should be resolved in favor of foreign investors.

The tribunal singled out at least one earlier ICSID tribunal, which presided over the case of SGS v. Philippines, and criticized its avowedly investor-centric approach.

Instead, the El Paso tribunal called for a balanced approach to investment treaty interpretation, one which takes into account "both State sovereignty and the State's responsibility to create an adapted and evolutionary framework for the development of economic activities, and the necessity to protect foreign investment and its continuing flow."

This rejection of the view that interpretive doubts should be resolved in favour of foreign investor interests would prove crucial in the El Paso case.

The tribunal was called upon to interpret the meaning of a vague provision of the US-Argentina BIT which mandates that "Each Party shall observe any obligation it may have entered into with regard to investments."

Investors, as well as some previous arbitral tribunals, have interpreted similar clauses so as to elevate all contracts between investors and states or state owned entities into the arbitration mechanisms of investment treaties.

However, the El Paso tribunal rejected such an interpretation, in so doing, aligning itself with several earlier tribunal rulings – but distancing itself from several others which had provided broad scope for contractual breaches to be asserted as treaty breaches.

Thus, the tribunal denied jurisdiction over any of El Paso's claims which were simple contractual breaches, and which did not rise to the level of a breach of some other treaty provision (e.g. fair and equitable treatment, national treatment, etc.)

Notwithstanding this ruling, the tribunal did affirm its jurisdiction over other forms of alleged treaty breach, thereby paving the way for the arbitration to proceed to a hearing of the merits.

The next item in this newsletter offers further analysis of the El Paso tribunal ruling.

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2. Analysis: Tribunal stirs up storm with 'umbrella' clause ruling,
By Luke Eric Peterson

The April jurisdictional ruling by the ICSID tribunal presiding in the El Paso v. Argentina dispute has reignited debate over the concrete meaning of an obscure – but potentially powerful - provision found in many bilateral investment treaties (BITs).

Sometimes referred to as an "observance of undertakings" clause or an "umbrella" clause, these provisions differ in nuance from treaty to treaty and have thus far occasioned widely divergent readings by arbitral tribunals.

The stakes of this debate are high, as lawyers acting for foreign investors typically assert that such clauses open up the possibility to sue states under international law whenever a contractual commitment or undertaking has been breached by a state or state agency – without it being necessary to prove some other breach of the relevant treaty.

On such a reading, these treaty clauses subsume all contractual breaches under the umbrella of the treaty, thus obviating the need for foreign investors to rely on the dispute settlement provisions contained in the relevant contract (for e.g. local courts or other forms of arbitration).
As far as can determined, given the lack of transparency in the field of investment treaty

arbitration, the first arbitral tribunal to wrestle with the meaning of such a treaty clause was in the case of SGS v. Pakistan at the Washington-based ICSID facility. In a 2003 ruling in that case, the presiding tribunal took a narrow view of Article 11 of the Switzerland-Pakistan BIT, which reads: “Either Contracting Party shall constantly guarantee the observance of the commitments it has entered into with respect to the investments of the investors of the other Contracting Party.”

Although counsel for the Swiss firm SGS had argued that Article 11 should be read as an ‘umbrella’ clause, the tribunal rejected such a reading, and warned that such an analysis would seem to render superfluous many other of the treaty provisions. In other words, if a simple breach of contract, or a breach of some local law or regulation, were sufficient to trigger state liability under the treaty, then many of the other treaty provisions would seem very much beside the point.

As is dutifully described by the El Paso Tribunal in its recent decision, subsequent tribunals would adopt strikingly divergent views as to the meaning of similar clauses in other BITs.

Several tribunals would take an expansive view of similar clauses in BITs, and find jurisdiction over claims arising out of alleged contractual breach. At the same time, several other arbitral tribunals, following the reasoning of the SGS-Pakistan tribunal, have held that such an expansive interpretation would require a much clearer statement of intention on the part of the governments concluding such treaties. In other words, if the parties to a BIT intended for any breach of a municipal (i.e. domestic) legal obligation to be considered as a breach of the treaty, then this should have been explained in much clearer terms.

After surveying the present state of confusion, the El Paso tribunal ultimately sides with those tribunals which followed the reasoning of the SGS-Pakistan case, thus holding that Article II (2) (c) of the US-Argentina BIT was not an umbrella clause, and that the commitments therein did not permit El Paso to allege that contractual breaches, in and of themselves, breached the BIT.

Indeed, the tribunal opined that foreign investors were unlikely to show restraint if given the opportunity to sue states under BITs for contractual breaches, nor should foreign investors be expected to exercise such restraint if the legal avenue were open to them. The tribunal added that “The responsibility for showing appropriate restraint rests rather in the hands of the ICSID tribunals.”

The El Paso decision serves to underscore the widely divergent – some would say flatly contradictory – decisions handed down by more than half a dozen tribunals in BIT cases which have had to interpret the clauses at issue.

While tribunals may continue to disagree as to how to interpret existing treaty provisions, it should be noted that the El Paso decision does hail the 2004 model US BIT for specifying that the ‘umbrella’ clause in that treaty covers certain categories of investment

agreements entered into by the host state as a sovereign with foreign investors, while not covering ordinary commercial contracts signed with the state or a state agency.

The fact that such a distinction can be drawn through more careful treaty drafting will be of interest to those governments wishing to clarify their own intentions in future treaties.

At the same time, the lack of a centralized appeals mechanism in investment treaty arbitration means that tribunals will remain free to construe BIT clauses in diverging, or even contradictory, fashion for the time being.

3. Tribunal allows NAFTA investment arbitration in softwood case to proceed in part, By Luke Eric Peterson

An international arbitration tribunal convened under NAFTA Chapter 11 has upheld jurisdiction over a portion of a claim by two Canadian softwood lumber firms, while declining jurisdiction over claims that countervailing and antidumping duties breach the terms of NAFTA investor protection s granted to Canadian firms.

In a "ruling on the preliminary question" rendered last week, the tribunal held that it could examine alleged breaches related to the so-called Byrd Amendment, a piece of US legislation which dictates that duties imposed on US-bound imports could be collected and redistributed to those US companies which had complained of being affected by unfairly subsidized imports.

The US Government had advanced several jurisdictional objections to the NAFTA Chapter 11 claims mounted by Canadian firms Canfor, Terminal forest Products and Tembec. In 2005, a consolidation order was rendered, following a request from the US Government, which brought all 3 NAFTA Chapter 11 claims under the purvey of a single arbitration tribunal. Subsequently, Tembec requested that its claim be terminated, as it is seeking in US Courts to challenge the consolidation order which joined the three claims together (see next story in this newsletter).

The presiding tribunal consisting of McGill University Professor Armand de Mestral, former US Secretary of State Legal Advisor Davis R. Robinson, and Erasmus University Professor Albert Jan van den Berg, addressed only one of the US jurisdictional objections in its Decision on the Preliminary Question rendered last week. The other jurisdictional objections will be joined to the merits phase of the claim.

Last week's tribunal decision hinged on the interpretation of the NAFTA's Chapter 19, which provides dispute settlement rules applicable to countervailing and anti-dumping disputes.

The United States Government argued that the presiding investment tribunal lacked jurisdiction because NAFTA Article 1901(3) clearly excludes the use of Chapter 11's

investor-state dispute settlement mechanism for disputes over countervailing or anti-dumping duties. On the US view, Chapter 19 clearly prescribed bi-national panels for resolution of countervailing or anti-dumping disputes, to the exclusion of all other NAFTA remedies.

Indeed, given that the USA has been embroiled in Chapter 19 litigation in relation to its treatment of Canadian softwood lumber, the US Government alleged that suits brought by individual investors under Chapter 11 could undermine "effective" dispute settlement under the NAFTA, and could give rise to the potential for conflicting judgments.

For their part, the claimants maintained that they were not challenging countervailing and anti-dumping duties per se, but rather the conduct of various US officials and agencies (for eg Commerce Department officials, and the International Trade Commission, etc.) in making determinations and applying them. The Canadian firms allege that US officials misapplied the laws, abused their discretion, and were motivated by political bias. They alleged that such misconduct breached provisions of NAFTA Chapter 11, namely those pertaining to National Treatment, Most-Favoured Nation Treatment, Minimum Standards of Treatment, and Expropriation.

Moreover, because these claims alleged conduct in breach of NAFTA Chapter 11 obligations - rather than claims of illegal rulings and determinations under US anti-dumping law - the claimants rejected the US contention that a NAFTA Chapter 11 suit could throw up the potential for conflicting judgments. In the view of the claimants, Chapter 11 and Chapter 19 claims were different claims, before different dispute mechanisms, and rooted in different applicable laws.

It fell to the presiding tribunal to interpret the meaning Article 1901(3), on which the US jurisdictional objection hinged, a provision which reads as follows:

"Except for Article 2203 (Entry into Force), no provision of any other Chapter of this Agreement shall be construed as imposing obligations on a Party with respect to the Party's antidumping law or countervailing duty law."

In the end, the tribunal would concur with the US position that Article 1901(3) did not permit Chapter 11 investor-state arbitration to apply to the countervailing or anti-dumping law of a State Party to NAFTA. The tribunal also made clear that claims alleging misconduct by government officials in relation to determinations and applications of US countervailing and anti-dumping law were precluded under Chapter 11.

However, at the same time, the tribunal was satisfied that the claimants had made at least a prima facie showing that claims related to the so-called Byrd Amendment – for example, the alleged differential treatment meted out to US and Canadian firms under the terms of the Byrd Amendment - could be held in breach of NAFTA Chapter 11 obligations.

The tribunal stressed, however, that it was making no judgment on the merits of such a claim, but simply confirming that the claims, if proven, were "prima facie capable of constituting a violation" of NAFTA Chapter 11 obligations.

In finding jurisdictional over the portion of the claim dealing with the Byrd Amendment, the tribunal ruled that the Byrd Amendment could not be characterized as countervailing duty or anti-dumping law, under the definition prescribed in NAFTA's Chapter 19.

In particular, the tribunal ruled that US authorities had failed to notify those Parties to the NAFTA which would be affected by that amendment. By dint of that failure, the Byrd Amendment did not meet the requirements set out in Chapter 19 to be considered countervailing duty or anti-dumping law, and as a consequence of this, the Byrd Amendment was not sheltered by the aforementioned exception, Article 1901(3), which served to preclude NAFTA Chapter 11 claims related to countervailing duty or anti-dumping laws.

In terms of the likely import of the tribunal's ruling, the tribunal noted that the recent move by the US Government to repeal the Byrd Amendment, in order to comply with earlier WTO rulings, does not affect the claimant's case in this NAFTA Chapter 11 arbitration. The allegations pertain to the period during which the Byrd Amendment was in force.

At the same time, the recent announcement of a political settlement of the softwood lumber case has not yet had any reverberations on this NAFTA Chapter 11 claim by the three affected Canadian softwood producers. The final terms of the settlement agreement have yet to be agreed between Canada and the United States. As such, ITN understands that there has been no move by the Canadian investors to withdraw their NAFTA Chapter 11 suit, or by the US Government to have the suit terminated on account of the potential political settlement.

Sources:

Decision on the Preliminary Question, June 6, 2006, available here on-line

4. Tembec trying to overturn softwood consolidation order in US courts,
By Damon Vis-Dunbar

The Canadian forestry products company Tembec has filed a motion with the United States District Court of Columbia to vacate a Consolidation Order handed down by a NAFTA tribunal.

As ITN reported in October, a three member Consolidation Tribunal, appointed by the Secretary-General of the International Centre for the Settlement of Investment Disputes (ICSID), ordered that three separate NAFTA Chapter 11 claims – brought by Canfor, Terminal and Tembec - be consolidated, in response to a request by the United States.

While Canfor and Terminal pursued arbitration under the consolidated claim, Tembec asked that it be removed from those proceedings, and announced that it would move to vacate the Consolidation Order in US District Court.

Tembec and the United States filed memorandums to the US District Court outlining their respective cases earlier this year. This week counsel for Tembec took a more aggressive posture and filed a request for a hearing. The United States has consented to that motion.

Counsel for Tembec focuses on three objections in its motion to vacate the Consolidation Order: that one member of Consolidation Tribunal, Davis R. Robinson, had an alleged conflict of interest; that the process for forming the Consolidation Tribunal was biased in favour of the United States; and finally that the tribunal exceeded its authority, as granted under NAFTA rules.

In response, the United States has challenged the US District Court's jurisdiction to vacate the tribunal's Consolidation Order on the grounds that it is not an "award," but rather a procedural order. While a final award would be open to a judicial challenge, a procedural order is not. The US has also countered each of the main objections made by Tembec, including Mr. Robinson's alleged conflict of interest.

The conflict of interest alleged by Tembec arises in part out of Mr. Robinson's family connections to the current US president, George W. Bush. Mr. Robinson is married to Suzanne Walker, who is a first cousin of the president. Tembec holds that since the dispute relates to US policies carried out under the President Bush's helm, Mr. Robinson's ties to president threaten his impartiality.

Tembec's motion also draws attention to Mr. Robinson's former position as a US Department of State legal advisor, working on foreign policy matters and international legal disputes. In effect, "Tembec is suing Mr. Robinson's principal former client," states counsel for Tembec.

It earlier fell on ICSID's former Secretary-General, Roberto Dañino, to make a decision on this challenge to Mr. Robinson when Tembec first raised the challenge, shortly after the Consolidation Tribunal was constituted. The then ICSID Secretary General held that "the somewhat distant familial relationship referred to in the challenge does not, in my judgment, raise justifiable doubts as to the impartiality or independence of Mr. Robinson." Nor does Mr. Robinson's former position as US State Department legal adviser, a job he held some 20 years ago, demonstrate a conflict of interest, according to Mr. Dañino.

The US attempts to add weight to Mr. Dañino's decision, stressing Mr. Robinson's "attenuated" relationship with President Bush, and noting that a number of high-level US Department of State officials have served as arbitrators in NAFTA Chapter 11 disputes.

Tembec's second objection to the Consolidation Order takes aim at the process that led to the composition of the tribunal. Under NAFTA rules, ICSID's Secretary General should look first to a permanent roster of arbitrators, nominated by the NAFTA governments, in selecting members of a NAFTA tribunal.

But this roster was never formed. That left the Secretary General to select from the ICSID Panel of Arbitrators, who have been nominated by the Centre's member governments. Mr. Robinson was nominated by the United States, a fact highlighted by Tembec in its motion to the District Court. The Secretary General also selected Professor Armand de Mestral, a Canadian, and Professor Albert Jan van den Berg, from the Netherlands to the Consolidated Tribunal.

That Mr. Robinson is an arbitrator whose name had been put forward by the United States, while Tembec "had no input into the selection of arbitrators," reveals a bias in favour of the United States, according to Tembec.

To this the US has countered that the tribunal was constituted in a manner that is consistent with NAFTA rules. "Had the NAFTA Parties wanted to impose additional limitations on the Secretary-General's selection of arbitrators, they could have done so … they did not," states the US response.

A similar reply is made to Tembec's claim that the Consolidation Tribunal exceeded its powers on a number of different fronts. Among these are that it should have restrained itself from acting while Tembec's challenge to Mr. Robinson was still pending, and that it ruled to consolidate the parties' claims prior to establishing whether valid claims existed in the first place.

This has been painted by the US as a "facial challenge" to NAFTA's Article 1126, under which the claims were consolidated, arguing that the tribunal acted well within the confines set by NAFTA in deciding to consolidate the three claims.

Tembec's intention in moving to vacate the Consolidation Order is to restore the original tribunal. However, in the event that the US District Court does not rule in its favour, avenues may still be open for Tembec to pursue its claim. Tembec could seek a new tribunal to hear its claim, since Tembec was not subject to the preliminary decision on jurisdiction handed down in the consolidated proceedings last week, suggests one source close to Tembec.

Sources:

Tembec Motion to Vacate Consolidation Order, Tembec, et al. v. United States of America, available here on-line

United States Opposition to Motion to Vacate, Tembec, et al. v. United States of America, available here on-line

"NAFTA Panel merges three arbitrations between US Govt and Canadian lumber firms", By Luke Eric Peterson, Investment Treaty News, October 4, 2005

5. First hearings held in Uruguay-Argentina pulp mill dispute,
By Damon Vis-Dunbar

The first public hearings were held last week at the International Court of Justice (ICJ) in a dispute between Argentina and Uruguay that centres on two pulp mills currently being constructed by foreign investors on the bank of the Uruguay River.

The two-days of public hearings follow Argentina's request for provisional measures, in which it asked that construction on the mills be stopped while the case is pending at the Hague-based ICJ. Cases take several years on average to reach a decision at the ICJ, while the mills are on target to be completed sometime between 2007 and 2008.

Argentina alleges that the pulp mills threaten the health of the river which borders the two countries, in violation of the Statute of the River Uruguay, a bilateral agreement on the river's management signed in 1975. Under this statute, Argentina maintains that it must be consulted and ultimately approve a project of this nature, with an impact on the River Uruguay. Barring such approval, the two countries must seek a decision at the ICJ.

Uruguay counters that the mills are being built to high international standards and any resulting pollution will be negligible. "Argentina presented some pretty bogus pictures of dark satanic mills which do not exist; the reality, as I hope to show, will be rather different," said Gros Espiel, a well-known arbitrator and current Uruguayan ambassador to France, in statements to the ICJ.

Uruguay has carried out an Environmental Impact Assessment (EIA) and concluded that it showed no significant harm to the Argentina or the river – although Argentina questions the quality of that EIA, while also accusing Uruguay of withholding information.

Both countries bring attention to the so-called Hatfield report, commissioned by the International Finance Corporation (IFC) to assess the IFC's own study of the environmental impact of the mills. That report is critical, noting for instance that "the reference to dioxins/furans in mill discharges appears to be handled in a rather cavalier manner. These compounds are of significant concern to the general public and should be discussed fully."

However, Uruguay argues that the Hatfield report addresses shortcomings in the IFC's own environmental assessment, and should not be read as a critique of its separate EIA.

While rejecting Argentina's claim that the mills will cause environmental harm to the river, Uruguay also holds that an order to halt construction on the mills would amount to

a decision on the merits of the claim, thus affirming Argentina's case.

The mills, which are the largest foreign investment project in Uruguay's history, are being built by the Finnish firm Oy Metsä-Botnia AB and the Spanish firm ENCE. "These (mills) are critical to Uruguay's hopes of advancing up to the next rung on the economic development ladder," Paul Reichler, a member of Uruguay's legal team, told the court.

Construction of the mills is expected to cost some $1.5 Billion US, and bring $350 Million US into the Uruguayan economy annually, representing 2 percent of Uruguay's GDP.

Notably, Uruguay has insisted that it could be liable for damages under the Finland-Uruguay bilateral investment treaty, should it stop the project, according to press reports.

Relations between Argentina and Uruguay, both members of the Mercosur customs union, have been tense during this standoff. Thousands of protesters have turned out for rallies in support of the project in Uruguay, while on the Argentine side of the river protestors have for months blocked access to a bridge joining the two countries.

A decision by the ICJ on Argentina's request for provisional measures is expected in the next few weeks.

Sources:

Documents from Pulp Mills on the River Uruguay (Argentina v. Uruguay) are available on-line from the International Court of Justice http://www.icj-cij.org/icjwww/idocket/iau/iauframe.htm

"Uruguay Rejects Presidents Plea to Halt Pulp Mills", Inter Press News Service, March 1, 2006

Negotiations Watch:

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6. Canada's Market Access Strategy Spells out Investment Agenda,
By Luke Eric Peterson

The Government of Canada published last week its 2006 International Market Access Report spelling out the country's trade and investment agenda.

The document offers data on Canadian trade and investment in various parts of the world, as well as an account of initiatives designed to reduce barriers to further cross-border economic activity. Its tone is one of urgency, in common with the prevailing view that

stalled multilateral and regional negotiations need be supplemented by vigorous bilateral initiatives.

In terms of investment rules, Canada reveals that it is continuing negotiations with Peru, India and China on bilateral investment treaties. Investment negotiations are also afoot with Singapore and four Central American countries (Guatemala, Honduras, El Salvador and Nicaragua) as part of more ambitious free trade talks.

Elsewhere in the Americas, preliminary discussions have begun on a possible free trade agreement (FTA) with the 15 members of the Caribbean Community (Caricom) although formal negotiations have not been launched. At the same time, consultations are under way with the Dominican Republic to explore potential negotiations on a BIT and a broader FTA.

In addition, the five members of the Andean Group (Bolivia, Venezuela, Colombia, Ecuador and Peru) requested consultations in 2002 to explore potential free trade negotiations. Presently, Canada has investment treaties with Ecuador and Venezuela, and should conclude a pact with Peru later this year.

Last year, Canada initiated a joint-study with Japan to explore the impact of potential liberalization of trade and investment between the two countries. This is a common step urged by the Japanese Ministry of Foreign Affairs (MOFA), and the MOFA website reveals that similar efforts have been launched with other potential trading partners including Australia and Korea.

Canada also undertook in 2004 to negotiate a Trade and Investment Enhancement Agreement with the European Union. This initiative would focus on so-called new-generation trade issues such as regulatory cooperation, intellectual property rights, services, and investment. However, last month Canada and the EU agreed to put these negotiations on hold, until the outcome of the WTO Doha Rounds negotiations becomes clearer.

Currently, Canada is a net exporter of capital, with the country receiving some $380 Billion in foreign direct investment in 2004, while exporting more than $440 Billion in that period. Of the latter, 45% of this sum is in the finance and insurance sector, while another 22% is invested in energy and metallic minerals.

Sources:

Canada’s International Market Access Priorities (2006), available here on-line.

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