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Contents at a glance:

Arbitration Watch:
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1. Cyprus-based companies recoup $75 Mil in BIT arbitration over Hungary airport,
By Luke Eric Peterson

A pair of Cyprus-based companies - ultimately owned by Canadian business interests - has been awarded more than 75 Million (USD) following a ruling that the Government of Hungary expropriated their investments in the Budapest Airport.

In an award rendered on October 2nd, a tribunal at the International Centre for Settlement of Investment Disputes (ICSID) held that Hungary's treatment of ADC Affiliate Limited and ADC & ADMC Management Ltd., had violated several obligations contained in the

Cyprus-Hungary bilateral investment treaty (BIT).

In particular, Hungary was held liable for expropriating the investors' interests without payment of full market-value compensation, as well as violating undertakings to provide "fair and equitable treatment" and "full protection and security" to Cypriot investors.

The investors were contracted to build a new terminal at the Budapest airport, and to collect revenues from the various businesses operating at the terminal (including passenger terminal usage fees, retail and duty-free outlet fees, and aircraft parking fees).

However, all agreements with the Hungarian government were voided in January of 2002, following a Decree by the government. Following this move, the claimants alleged that they were no longer able to operate the terminal or to collect revenues; they launched a series of arbitrations, including the BIT claim against Hungary at ICSID.

In its finding of expropriation, the tribunal rejected Hungary's plea that it had been entitled to exercise its "right to regulate", and that foreign investors entering the country should "assume the risk of being regulated by the host State."

In response to Hungary's arguments, the tribunal held that a sovereign state will enjoy a right to regulate, but that this is "not unlimited and must have its boundaries" – including those set by the rule of law, and the host country's international treaty obligations.

The tribunal added that foreign investors were entitled to expect that if Government were to expropriate their holdings, then they would "receive fair treatment and just compensation".

The tribunal's quantification of compensation is notable for having sought to "restitutionalize" the investors i.e. place them in a financial situation similar to that which would have prevailed had the expropriation not occurred. Accordingly, the tribunal took into account the fact that the value of the lost investments had swelled in the intervening years; and the tribunal calculated the compensation from the date of the award, rather than the (earlier) date of the expropriation.

In addition to awarding compensation for expropriation, the tribunal also ordered that Hungary pay the full costs of the claimants, amounting to some $7.6 Million (US) and representing legal fees and the claimants' share of the arbitration costs.

The Hungarian Government has agreed to abide by the tribunal's finding and this week paid full compensation to the affected investors.

For its part, Hungary had disputed the tribunal's jurisdiction over the investors' claim on grounds which questioned whether the Cyprus-Hungary treaty should provide protection to mere "shell companies".

As summarized in the arbitral award, Hungary had insisted "that the Claimants are nothing but two shell companies established by Canadian investors and all the facts, including those related to the structuring of the Project Company and even the involvement of the Canadian Government when the dispute initially arose, indicate that the investments were made by Canadian companies rather than Cypriot ones."

Hungary asked the tribunal to "pierce the corporate veil" of the two claimants, i.e. to look beyond the "formal nationality" of the companies in question, and to find that the Cypriot nationality was being misused by the investor in order to sue Hungary under the Cyprus-Hungary BIT.

For their part, the claimants responded that the incorporation in Cyprus had been a "commercially sensible" decision – taking account of various factors including the favourable tax regime in Cyprus – and a decision of which Hungary had been fully aware. What's more, the investors argued that the past involvement of the Government of Canada in the dispute – writing several letters on behalf of the Canadian owners to the Hungarian Government – should not preclude the owners from using Cypriot companies to make their investments, or from bringing a claim under the Cyprus-Hungary treaty.

Ultimately, the tribunal would hold that the Cyprus-Hungary treaty set the bar at a low level for jurisdictional purposes; the treaty merely required that an "investor" be a legal person incorporated in compliance with Cypriot law, without any additional requirement that the origins of the investor's capital be scrutinized. In other words, Canadian control of the Cypriot companies was irrelevant for purposes of determining whether the Cypriot companies were entitled to sue Hungary under the Cyprus-Hungary BIT.

What's more, the tribunal observed that "The BIT applies or it does not. It cannot be made to disapply simply because, rightly or wrongly, the Claimants' shareholders appealed for help to Canada."

Also, noteworthy is the fact that the relevant BIT contains a narrow jurisdictional clause, similar to those in many other BITs concluded by former Soviet or Eastern Bloc countries. Specifically, Article 7 of the Cyprus-Hungary BIT provides for investor-state arbitration only in case of disputes "concerning expropriation of an investment".

While the tribunal did not have jurisdiction over disputes relating to the "fair and equitable treatment" and "full protection and security" guarantees found in Article 3 of the treaty, those obligations were deemed to have been breached by the tribunal – most likely because the claimants had argued that the requirement for expropriations to be taken according to "due process of law" required that the claimants were not subjected to a "denial of justice" or a denial of "fair and equitable treatment".

The award, which has been published by the ICSID, following the consent of the two parties, is available on-line here:
http://www.worldbank.org/icsid/cases/pdf/ARB0316_ADCvHungary_AwardOctober2_2006.pdf

2. UK Court of Appeal to hear challenge by Ecuador to Oxy award on January 29,
By Luke Eric Peterson

Hearings have been scheduled before the UK Court of Appeal, in a further effort by the Republic of Ecuador to challenge an arbitral award which was handed down in an earlier investment treaty dispute with US-based Occidental Petroleum.

As was earlier reported in ITN, Ecuador turned to the UK courts after a tribunal operating under the UNCITRAL rules of procedure had held the Ecuadorian Government liable for some $75 Million (US) in compensation in a dispute over value-added tax rebates allegedly owed to Occidental.

In July of 2004, the arbitral tribunal held Ecuador to have violated several provisions of the US-Ecuador bilateral investment treaty, including those on national treatment and fair and equitable treatment. (See: "Occidental wins investment arbitration against Ecuador; Ecuador vows 'appeal'", available on-line at:
http://www.iisd.org/pdf/2004/investment_investsd_july16_2004.pdf)

Because the arbitration was not conducted according to the self-contained arbitration rules of the International Centre for Settlement of Investment Disputes (ICSID), Ecuador was able to turn to a domestic court in an effort to challenge the international arbitration award. (In contrast to such UNCITRAL-based arbitrations, those arbitrations conducted according to the ICSID arbitration rules may only be challenged via an internal annulment process administered by the Washington-based ICSID, thereby eliminating the prospect of outside court review).

After losing its arbitration with Occidental, Ecuador turned to the UK courts in September of 2004 in the hope of having the award set aside. However, in March of this year, Justice Aikens of the UK High Court of Justice rejected Ecuador's bid. Justice Aikens held that the original arbitration tribunal had not exceeded its jurisdiction or its powers and, as such, the award could not be set aside under the terms of the UK's Arbitration Act of 1996. (ITN's reporting on the UK High Court ruling can be found here: http://www.iisd.org/pdf/2006/itn_mar14_2006.pdf) Ecuador is now appealing this High Court ruling, and the UK Court of Appeal is slated to hear arguments on Jan 29th 2007.

Meanwhile, relations between Ecuador and Occidental have deteriorated progressively, culminating in a decision earlier this year by Ecuadorian officials to cancel a major oil contract with the US-based firm. Immediately thereafter, Occidental filed for another arbitration, this time at the ICSID facility, alleging expropriation of its investments. That claim was registered by ICSID on July 13th, and an arbitral tribunal was still being nominated by the parties at press time. (See: "Occidental files BIT claim against Ecuador at ICSID", http://www.iisd.org/pdf/2006/itn_may18_2006.pdf)
Occidental has posted a copy of its Arbitration request on its website:

http://www.oxy.com/PUBLICATIONS/PDF/Request%20for%20Arbitration.pdf

3. ICSID tribunal can hear dispute between French energy firm Total and Argentina, By Fernando Cabrera Diaz

An arbitral tribunal set up under the World Bank's International Centre for the Settlement of Investment Disputes (ICSID) has ruled that it has jurisdiction to hear a dispute launched by French company Total against the Republic of Argentina under the Argentina-France bilateral investment treaty (BIT).

Total, the fourth largest energy company in the world, has a variety of investments in the energy sector in Argentina, including ownership of shares in major electricity producers Central Puerta S.A. and Hidroelectrica Piedra de Aguila S.A, which account for over 15% of Argentina's total electricity capacity.

According to Total, it made these and other investments based on guarantees from Argentina about the legal and regulatory framework that would govern their industries after the privatization of the energy sector that occurred in the late eighties and early nineties.

The dispute like many others previously reported on by ITN, centers on Argentina's response to its financial crisis beginning in the late nineties. During the crisis Argentina enacted a set of controversial emergency measures aimed at avoiding a complete financial meltdown.

The company alleges that the emergency measures taken by Argentina violated several provisions of the Argentina-France BIT including the prohibition against expropriation without just compensation found in Article 5.2 of the BIT. The French firm is seeking no less than 940 million USD in compensation.

Argentina objected to the tribunal's jurisdiction over Total's claim – invoking similar grounds to those it has raised in past ICSID disputes.

Argentina again argued that general measures of a host country cannot be challenged as being a breach of the BIT. The tribunal rejected this argument, however, reconfirming that an impugned measure does not have to target particular investments for it to violate a BIT.

Along the same lines, Argentina argued that Total's damages were the result of a general economic crisis and therefore should be borne by the company. The tribunal rejected this view holding that Total's claim involves damages it alleges were the result of the emergency legislation and not the crisis itself.

The case will now move to a hearing on its merits. A copy of the jurisdictional decision has been posted in the ITN Documents Centre:

http://www.iisd.org/investment/itn/documents.asp

Negotiation Watch:
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4. Mexico and Spain sign new Bilateral Investment Treaty,
By Fernando Cabrera Diaz

Mexico and Spain have signed a new Bilateral Investment Treaty (BIT) to replace their previous BIT signed in 1995. The BIT retains the basic framework of the previous treaty, but makes several notable changes as a result of lessons learned over the 10 year lifespan of the previous treaty.

First, changes were made in relation to trade promotion and protection. Two clauses in Article 2 relating to the promotion of investments have been deleted from the new BIT; as such, provisions were not intended to create positive obligations for the governments signing the original BIT.

Also, a separate article (Article 3) on "protection" of investments has been omitted entirely from the new BIT. Accordingly, detailed provisions relating to the granting of licenses and authorizations and to the requirement that states not subject investors to arbitrary or discriminatory measures have been removed from the BIT. Instead, the new BIT contains separate clauses which deal with national treatment, most-favoured nation treatment, and minimum treatment (which is defined so as to encompass fair and equitable treatment and full protection and security).

Second, certain changes have been made to the expropriation section of the BIT. A new clause was added giving investors the right to have expropriations reviewed by domestic judicial authorities or independent competent authorities. These authorities can determine whether expropriations have occurred, and conduct valuations of expropriated investments (for purposes of indemnification).

A third change takes place in relation to transfers of funds into and out of the country. A new clause was added to the Spain-Mexico BIT which allows a party to stop transfers of assets relating to an investment in certain cases. These circumstances include where a given investor has violated legal or administrative rules; where bankruptcy or insolvency threaten the rights of creditors; and where it is necessary to guarantee the payment of awards in legal disputes. These exceptions supplement an existing exception which provides for limits on transfers in case of Balance of Payments difficulties.

Fourth, several changes were made to the dispute settlement mechanism. For one, the new chapter on dispute settlement is included in the BIT rather than being annexed to it. The notice of intent provision was modified so that investors must wait six months from the time they signal their intent to arbitrate before they can begin arbitration – rather than the 90 days as prescribed by the original BIT.

A fifth notable change in dispute resolution comes in relation to the softening of the so called ‘fork in the road clause’ often found in BITs. These clauses purport to force investors to make a choice between taking a particular dispute to domestic courts or international tribunals, but not to both.

The original BIT had what can be characterized as a strong fork in the road clause. Under that BIT, investors who initiated a process in a domestic court with respect to a measure taken by the State, could not then take advantage of the dispute resolution mechanism within the BIT to challenge that measure in international arbitration. Similarly, investors who used the dispute resolution mechanism within the BIT to challenge a government measure at an international arbitration tribunal could not then challenge the same measure in domestic courts.

The new BIT has a markedly softer fork in the road clause in several ways. Only when an investor alleges in a domestic court that the government has violated a provision of the BIT is that investor barred from challenging that violation using the BIT’s dispute resolution provisions. An investor who merely challenges a government measure under domestic law (without construing such a challenge as a violation of the BIT protections) in domestic courts, can still challenge the alleged violation of the BIT obligations using the BIT’s international arbitration clause, as long as the domestic court action is halted.

Another change in the fork in the road clause is that it is no longer applicable to cases in which an investor is seeking preliminary injunctions in a domestic court. This means investors can now pursue international arbitration under the BIT while at the same time seeking a preliminary injunction in domestic courts to prevent expropriated assets from being transferred to third parties or otherwise disposed of.

The new BIT must now be passed by the legislatures in both Mexico and Spain before it enters into force.

Briefly Noted:
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5. U.S. lumber firm Merrill & Ring notifies Canada of NAFTA suit over log exports,

American timber company, Merrill & Ring Forestry Ltd., has served Canada with a notice of intent to seek arbitration under Chapter 11 of the North American Free Trade Agreement (NAFTA). The firm accuses Canada of adopting a “protectionist industrial policy of favoring log processors in British Columbia at the expense of timber harvested from privately owned land”.

Merrill & Ring grows, harvests, and sells timber from a number of lands it owns in the

Province of British Columbia. According to a company official Merrill & Ring owns approximately 8,000 acres of land in British Columbia, distributed in a variety parcels along the coast of the province.

The vast majority of this land was granted by the Federal Crown prior to 1906, which Merrill & Ring says, means the land is subject to federal, rather than provincial control.

The US firm alleges that Canada's Federal Government administers an export control system for logs which runs contrary to the investor protections contained in NAFTA Chapter 11. The system prohibits the export of logs unless provincial demand in British Columbia has been met. Only when there are no domestic buyers - at what the US company characterizes as "the artificially reduced British Columbia price" - is the company granted a permit to export a particular batch of lumber outside of the province. As such, the US company alleges that it is "substantially deprive(d)" of its right to sell logs at international market prices.

Another bone of contention for Merrill & Ring is the distinction made between lands regulated by Federal versus Provincial governments. The company challenges the fact that provincially regulated timber lands can receive certain types of blanket exemptions from the export prohibitions, while such exemptions are not available to federally regulated lands.

The firm also alleges that certain aspects of the administration of the export regime are non-transparent and arbitrary, leading to further violations of NAFTA Chapter 11's promise of national treatment and fair and equitable treatment.

Merrill & Ring's notice of intent is available here:
http://www.dfait-maeci.gc.ca/tna-nac/documents/MerrillRingForestry.pdf

6. OECD unveils latest initiative: draft principles to govern infrastructure investment,

The Organisation for Economic Cooperation and Development (OECD) is continuing to develop guidelines applicable to foreign investments, as the Paris-based inter-governmental organization unveils this month a series of draft principles for international investor participation in infrastructure.

The draft principles are designed to facilitate foreign investor participation in large infrastructure projects, by setting forth a check-list of challenges to be addressed by governments, including in relation to striking the right balance on public subsidization of infrastructure; providing an "enabling" framework attractive to investment; and clarifying government's expectations as to what constitutes "responsible business conduct".

The OECD is hosting a Global Forum next week in Turkey which will discuss investments in infrastructure, as well as the draft principles. A copy of the draft principles is available on-line (see address below). The document was drafted by the OECD Secretariat and further revisions are anticipated following this month's meeting in

Turkey.

See: http://www.oecd.org/dataoecd/23/31/37617810.pdf

7. British Institute plans January event on Russia and Energy Charter,
The British Institute for International and Comparative Law (BIICL) will host an informal seminar on January 24, 2007 to discuss "Energy Investment in Russia and the Role of the Energy Charter Treaty". The event is to be organized by the BIICL's Investment Treaty Forum.
The plurilateral Energy Charter Treaty (ECT) governs trade and investment in the energy sector, and contains comprehensive legal protections for foreign investors. In recent months, Russia has come under diplomatic pressure from the European Union to ratify the ECT – something which the country has been loath to do.
Meanwhile, questions abound as to the legal significance of Russia's earlier signature to the ECT. The treaty contains a novel provision on "provisional application" which is triggered following signature of the treaty. This issue is likely to be explored in the ongoing arbitration between Group Menatep (the majority shareholders in the Yukos Corporation) and the Russian Federation. (See earlier ITN reporting on this case: http://www.iisd.org/pdf/2005/investment_investsd_feb22_2005.pdf)
For more information about the BIICL event, see: http://www.biicl.org/itf/
