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Contents at a Glance:

Arbitration Watch:

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1. Underwater salvaging firm fails “investment” test in ICSID case against Malaysia, By Damon Vis-Dunbar

A tribunal of the International Centre for the Settlement of Investment Disputes (ICSID) has declined jurisdiction in a case involving a salvage operation off the coast of Malaysia.

The investor, Malaysian Historical Salvors, had retrieved some 24,000 pieces of Chinese porcelain from the Straight of Malacca in the early 1990s. The treasure sunk in 1817 along with the wooden cargo ship Diana, as it journeyed from China on its way to India.

Much of the porcelain was sold at auction in 1995 for $3.4 Million (US). Malaysian Historical Salvors later alleged that it received a smaller share of the profits than it was promised under its contract with Malaysia. Following an unsuccessful bid to sue Malaysia through domestic arbitration fora, the company sought relief through international arbitration under the UK-Malaysia bilateral investment treaty (BIT).

In coming to a decision on jurisdiction, Michael Hwang, the sole arbitrator, wrestled with whether the company had an “investment” in Malaysia as intended under the ICSID Convention. While the ICSID Convention does not provide an explicit definition of investment, various characteristics of an investment have been drawn from the Convention by commentators and tribunals.

Typical features of an investment identified by Mr. Hwang often include: regular profits and returns resulting from the contract; a certain expenditure of funds, equipment, expertise and personnel; a minimum duration of the contract; and a degree of risk assumed under the contract.

Since the unusual nature of the salvage company’s activities meant that some of these criteria were either not met, or met superficially, Mr. Hwang paid particular attention to a final criterion: whether the contract made a significant contribution to the economic development of host state.

Tribunals have taken differing positions on whether there is a need for a contract to make a significant contribution to the economic development of the host state in order to constitute an investment under the ICSID Convention. Mr. Hwang concluded that the weight of these decisions favoured the view that a contract should bring significant economic benefits.

“Were there not the requirement of significance, any contract which enhances the Gross Domestic Product of an economy by any amount, however small, would qualify as an ‘investment’”, argued Mr. Hwang.

Mr. Hwang ultimately decided that the retrieved treasure did not make a significant contribution to the Malaysian economy. The claim that local residents were employed to “wash, pack, inventory and photograph the porcelains” did not meet the “quantity or quality” envisaged by ICSID jurisprudence, nor should cultural and historical benefits be conflated with economic benefits, held Mr. Hwang.

Having decided that Malaysian Historical Salvors’ contract with Malaysia did not constitute an investment under the ICSID Convention, it was unnecessary to determine whether it met the definition of an investment under the UK-Malaysia BIT. In the sole arbitrator’s view, the claim could not be arbitrated under the ICSID Convention.

Counsel for the Claimant has said that Malaysian Historical Salvors intend to seek annulment of the award. Under ICSID rules, a party has 120 days from the date of an award by which to file that request.

The parties to the arbitration were ordered to bear their own legal costs, and to share the costs of the arbitration proceeding.

Sources:

The decision on jurisdiction in Malaysian Historical Salvors, SDN, BHD v. Malaysia is

available from the ICSID website at:
http://www.worldbank.org/icsid/cases/pdf/MHS_v_Malaysia_Award.pdf

Eren Law, the law firm for the Claimant, has also published pleadings and transcripts of the hearings on its website, available at: http://www.erenlaw.com/news/

"British investor sues Malaysia over sunken treasure, pleadings posted by ICSID", By Damon Vis-Dunbar, Investment Treaty News, April 11, 2006

2. Recently published UPS v. Canada decisions reveal arbitrator divergences over NT, By Luke Eric Peterson

A pair of arbitration rulings in a long-running NAFTA dispute between United Parcel Services UPS) and the Government of Canada have recently been released to the public.

As was reported earlier this month, a majority of the three member arbitral tribunal ruled in favour of Canada in rejecting UPS's claims that Canada and its monopoly postal service engaged in discriminatory and anti-competitive practices contrary to NAFTA obligations owed to UPS.

Arbitrator Ronald Cass, Dean Emeritus of the Boston University Law School, while concurring with arbitrators L. Yves Fortier and Judge Kenneth Keith on many fronts, diverged with the majority on several key issues. Among the points of disagreement were the proper application of the NAFTA Chapter 11 National Treatment obligation to the facts of the case (see below), as well as the question as to whether certain of Canada's conduct was immune from scrutiny thanks to a NAFTA exception reserved for "cultural industries" (see next story).

For its part, the majority struck down several of UPS's claims because the actions of Canada's postal monopoly, Canada Post, could not be attributed to Canada for purposes of liability under the relevant provisions of NAFTA Chapter 11.

The majority also examined an argument by UPS that certain actions by Canada Post served to render Canada liable for breaches of NAFTA Articles 1502(3) (1) and 1503(2) of the NAFTA – two provisions which place certain strictures on the activities of state-enterprises or monopolies.

UPS had complained, in particular, that Canada Post had permitted its monopoly infrastructure to be used for certain Canadian courier and other services, without extending the same privileges to UPS.

However, the majority of the tribunal held that the actions which drew the ire of UPS could be characterized as "commercial activities" of Canada Post - rather than delegated acts of governmental authority – thus exempting Canada Post from breach of the NAFTA Articles in question.

The majority did go on to examine another claim by UPS: that Canada had unfairly enforced its customs law so as to provide greater benefits to Canada Post than to UPS. Accordingly, the tribunal explored whether Canada had breached its National Treatment obligation to UPS by providing greater customs benefits to Canada Post.

Under the terms of Article 1102 on National Treatment, Canada is obliged to treat US investors no less favourably than Canadian investors; however, a key requirement is that the US and Canadian investors be "in like circumstances" to one another.

Upon further review, Messers Fortier and Keith ultimately held that Canada Post and UPS were, in fact, in different circumstances to one another, and thus the latter was not owed customs treatment no less favourable than that extended to Canada Post. Among other things, the majority laid emphasis upon the different character of Canada Post, including its universal service obligations (i.e. the duty to provide postal service to all Canadians regardless of geographical location) flowing from international postal accords.

DISSENTER REACHES DIFFERENT NATIONAL TREATMENT FINDINGS

In his dissent, arbitrator Ronald Cass expressed support for the test adopted by the majority for purposes of assessing whether a foreign investor has received National Treatment in accordance with NAFTA Chapter 11's strictures.

In so doing, Cass emphasized that he favoured a definition of the pivotal term "in like circumstances" which strikes a middle-ground between the approach advocated by UPS on the one hand, and the Government of Canada on the other.

The definition of "in like circumstances" is critical insofar as it serves to determine which enterprises or investors can be legitimately compared to one another to see if they have received comparable treatment.

For its part, UPS had advanced an interpretation which was based upon economic competition; if two or more enterprises were competing or operating in the same economic sector, then this would be an indication that they are "in like circumstances" for purposes of assessing whether one receives more favourable treatment than the other.

The Government of Canada had countered that arbitrators should show deference to the decisions of governments with respect to whether there were valid public policy reasons for treating two different enterprises differently (i.e. unlike).

In rejecting Canada's favoured approach, Dean Cass noted that it would give too much leeway to governments to judge when public policy reasons dictated different treatment of selected investors. At the same time, he rejected UPS's "economic competition" approach as too mechanistic.

Ultimately, Cass was of the view that economic competition between two entities provides a "prima facie" case that the entities are in like circumstances, however the host government might still rebut this case by offering reasons as to why the entities are not in like circumstances.

On the facts of the case, Cass held there to be a prima facie case that Canada Post and UPS were in like circumstances because they offered similar products and competed for similar customers in the courier marketplace.

Moreover, Cass was unimpressed by the arguments raised by Canada to rebut UPS's claim that UPS and Canada Post were in like circumstances.

Thus, Cass went on to hold that, in three key respects, Canada had denied UPS the national treatment that was owed to it under NAFTA Chapter 11. Specifically, Cass upheld UPS arguments that it had suffered less favourable customs treatment than that enjoyed by Canada Post; abuses of Canada Post's monopoly infrastructure for non-monopoly services such as courier services; and less favourable treatment under Canada's Publications Assistance Program (see next section).

3. UPS arbitrators differ on reading of cultural industries exclusion in NAFTA,
By Luke Eric Peterson

Among the claims made in the UPS v. Canada arbitration, UPS had challenged the Publications Assistance Program (PAP), a scheme whereby eligible Canadian publications such as magazines and periodicals enjoy subsidy payments which defray certain costs associated with publication and mail delivery. UPS argued that the PAP scheme unfairly discriminates against UPS, by designating Canada Post as the exclusive delivery channel for PAP-eligible publications.

For its part, the Canadian Government argued that the PAP scheme was part of a cultural policy which promotes the Canadian publishing industry and the wide dissemination in Canada of Made-in-Canada cultural products.

Canada insisted that the PAP was sheltered from arbitral scrutiny thanks to a NAFTA exception applicable to "cultural industries".

UPS countered that the cultural industries exclusion ought not to apply to the PAP because it was a mere delivery mechanism not integral to the cultural industries (periodicals and magazine production) in question.

Ultimately, a majority of the tribunal held that the relevant NAFTA exemption had been drafted so as to provide broad and expansive shelter for cultural industries. In particular, the majority ruled that the PAP scheme's exclusive reliance upon Canada Post as a delivery agent served to reach the widest range of Canadians in the most efficient manner possible and, as such, was an integral part of Canada's cultural policy.

The majority did note, however, that the cultural industries exclusion would have some limits, so that not every government measure which purports to reflect some cultural policy would be covered by the treaty clause in question.

However, in the present case, the majority of the tribunal had little difficulty holding that a requirement for publishers to use Canada Post to deliver PAP-eligible publications was "rationally and intrinsically connected to assisting the Canadian publishing industry."

THIRD ARBITRATOR READS CULURAL INDUSTRIES CLAUSE NARROWLY

The third member of the arbitral tribunal took a more skeptical view of Canada's argument that its PAP scheme was sheltered from NAFTA review by virtue of the cultural industries clause.

Dean Cass gave some credence to UPS's contention that the NAFTA exception ought to be "limited to activities closer to the core of the cultural enterprise." In his dissenting opinion, Cass observed that there must be some logical limit on the coverage of the cultural industries exclusion clause so that it cannot be extended beyond "any reasonable and foreseeable bounds" and encompass business activities which are largely ancillary to cultural production. Cass observed, by way of analogy, that Canada might have utilized taxicabs to deliver Canadian periodicals, and that this ought not to convert the taxi business into a "cultural industry" for purposes of NAFTA.

In summing up his findings on this point, Cass wrote:

"I conclude, after examining Canada's explanations and UPS's responses that Canada has not established any necessary basis connected to a cultural industry that requires Canada to structure the subsidy in the way it has chosen. Rather, Canada's support for Canada Post through the PAP appears to be at least partially a subvention to Canada Post rather than to Canadian publications. That subvention is not within the cultural industries exception to ordinarily applicable NAFTA disciplines."

Having held that cultural industries exclusion did not offer Canada a defence against this particular claim, Cass turned to examine whether the Government of Canada had treated UPS less favourably – contrary to NAFTA Article 1102 – in relation to the PAP scheme. Ultimately, as was noted in the previous story, Dean Cass held that UPS had been denied national treatment thanks to the operation of the PAP.

WILL FUTURE CLAIMS TARGET PUBLIC ENTERPRISES IN SIMILAR FASHION?

In comments reported in the mainstream media, some observers have suggested that the outcome of the UPS case might forestall other similar challenges by foreign investors, particularly in relation to government services or enterprises that might be alleged to compete unfairly with foreign-owned private enterprises.

However, it ought to be recalled that arbitral awards are not strictly binding on future tribunals, leaving the door open for differently-constituted tribunals (whose members are typically selected by the parties to a given dispute) to reach differing findings in similar cases in future. While arbitral tribunals sometimes give credence to earlier rulings, they have also been known to fall out over the appropriate interpretation of basic investment treaty obligations.

Only time may tell what weight will be attached by future arbitrators to the competing opinions by the majority and minority in the UPS case. While foreign investors might think twice about investing millions of dollars in legal challenges similar to the UPS claim, governments might also have some cause for uncertainty as to how future cases might be handled where different arbitrators are presiding – particularly given that the three arbitrators presiding in the UPS case themselves diverged on major matters before the tribunal.

Negotiation Watch:
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4. EU members review intra-European BITs in light of potential overlap with EU Law, By Damon Vis-Dunbar

Despite raising concerns last year that some 150 bilateral investment treaties (BITs) between European Member States may be superfluous in light of the wider body of European Union law, the European Commission (EC) – the executive branch of the European Union - has not formally asked that these BITs be amended or terminated. However, officials from European Member States contacted by ITN expect the EC to push for resolution on this matter shortly.

The EC is currently challenging several European governments at the European Court of Justice (ECJ) over alleged conflict between the EU Treaty and their BITs with non-European governments (see further discussion below). The EC will likely wait until the court makes a decision on these extra-European BITs before adopting a formal posture with respect to intra-European BITs, said a European government official. An ECJ decision is expected to come down within the year, said this person.

Officials from the EC questioned the need for intra-European BITs last year in an informal note to a committee that reviews the EU's internal market policies. In that message to the Economic and Financial Committee (EFC) - a body with members from European Member States, the European Commission and the European Central Bank - these officials said:

"There appears to be no need for agreements of this kind in the single market and their legal character after accession is not entirely clear. It would appear that most of their content is superseded by Community law upon accession of the respective Member State."

In response, the Committee noted in its 2006 annual report that “in order to avoid legal uncertainties and unnecessary risks for Member States in the unclear situation, Member States are invited to review the need for such agreements; and inform the Commission about the actions taken in this context so that progress can be reviewed by the EFC by the end of 2007”.

Yet some European governments appear reluctant to see intra-European BITs terminated, since they offer rights and protections to foreign investors not found in EU law. For example, a number of officials in European governments contacted by ITN noted that an investor-state dispute settlement mechanism for foreign investors is a component of bilateral investment treaties which is not found under EU law. This mechanism permits international arbitration in lieu of recourse to domestic or EU-level courts.

However, misgivings about phasing out such pacts are not shared by all European governments. One European Government official who works on investment issues said “it doesn’t make sense to have these agreements.” This person said that European courts were capable of settling disputes between investors and EU governments. Moreover, Member States could always agree to introduce new legislation into the EU Treaty to make up for rights and protections that may be lost if intra-European BITs were terminated.

While few BITs exist between older European Member states (for example, Germany, France and the Netherlands), a web of treaties exists between long-standing EU member-governments and the more recent entrants to the EU, such as Poland, Hungary and Romania.

EU GOVERNMENTS AWAIT DECISION ON EXTRA-EUROPEAN BITS

While the EC is currently taking a more tentative approach with respect to intra-European BITs, it has been more active when it comes to BITs between EU Member States and non-European governments. As ITN has reported, three countries – Finland, Austria and Sweden – currently face legal challenges brought by the European Commission at the European Court of Justice (ECJ), after these countries refused to re-negotiate bilateral investment treaties that allegedly clash with the EU Treaty. A particular source of concern for the EC is that these BITs contain obligations providing for the free transfer of investment related capital without the type of exceptions or safeguards that are built into EU law as it pertains to capital movements.

The EC has singled out Finland's BITs with Russia, Belarus, China, Malaysia, Sri Lanka and Uzbekistan; Austria's BITs with Korea, Cape Verde, China, Malaysia, Russia, and Turkey; and some 17 of Sweden's bilateral investment treaties.

Meanwhile a number of more recent entrants to the European Union are in the process of renegotiating certain extra-European bilateral investment treaties, in order to bring them into conformity with the EU Treaty. Romania and Bulgaria confirm that they have notified treaty partners of the need to revise BITs in areas such as most favoured nation treatment, national treatment, transfer of funds and performance requirements. For these countries, some amendments have already been concluded, others await ratification, and still others have yet to be negotiated.

Poland, on the other hand, has begun by re-negotiating with the United States and Canada, and intends to finish those negotiations before moving on to other treaties, said an official with that country. While the negotiations with the United States are concluded, they remain ongoing with Canada. The Canadian agreement will then act as a model for amendments with other countries.

Meanwhile, ITN understands that Hungary and Lithuania are not embarking on a widespread revision of their extra-European BITs. While Hungary is negotiating with Canada on an updated bilateral investment treaty, it does not intend to revise other BITs, said an official from that country. Indeed, Hungary and Lithuania are intervening at the European Court of Justice in support of Finland, Austria and Sweden.

Sources:

ITN interviews

Czech Rep and Hungary opposed to Canada's investor-state transparency demands, By Damon Vis-Dunbar, Investment Treaty News, April 27, 2007

"Czech Republic loses BIT arbitration to sugar firm challenging quota allocation", By Luke Eric Peterson, Investment Treaty News, April 13, 2007

"European Governments defend BITs in lawsuit brought by EU Executive Branch", By Damon Vis-Dunbar, Investment Treaty News, March 16, 2007

Briefly Noted:

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5. US campaign groups criticize investment agreements and arbitration in new report

Two US-based groups have released a 48 page report which presents a range of criticisms of international investment agreements and the arbitration processes contained in such agreements. The report also sets forth various proposals which the authors insist would rein in the "excessive powers" granted to multinational corporations under the terms of such agreements.

The report by the Institute for Policy Studies and Food & Water Watch is available here:
http://www.ips-dc.org/reports/070430-challengingcorporateinvestorrule.pdf

6. BIICL's Investment Treaty Forum sets Sept.14 for conference in London

The Investment Treaty Forum of the British Institute for International and Comparative Law has announced that its next conference will take place this year in

London on September 14th. The day-long event will feature a range of panel presentations and discussion under the banner of “the Emerging Jurisprudence of International Investment Law”. Further information about the event will become available at the following website: http://www.biicl.org/events/view/-/id/153/

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