

Investment Treaty News (ITN), March 29, 2006

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

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Arbitration Watch:

1. Saluka Investments claims partial victory against the Czech Republic,
By Damon Vis-Dunbar and Luke Eric Peterson

On the Monday morning following a partial award in favour of Saluka Investments, the Czech Koruna dropped against the Euro – a testament to the potential gravity of the arbitration ruling handed down against the Czech Republic. By the afternoon, however, the Koruna had recovered; a sign that the outcome of the dispute between the Dutch-based subsidiary of the Japanese financial group Nomura and the Czech Government remains unclear.

In a unanimous partial award, a three-member arbitral tribunal ruled that the Czech Republic was in breach of the Fair and Equitable Treatment provision of the Czech-

Netherlands bilateral investment treaty, due to its discriminatory treatment of a Czech bank in which Saluka held a stake. However, the tribunal did not find that Saluka's investment had been expropriated, or "deprived" of its investment as had been alleged.

Damages will be determined in a separate, upcoming phase of the arbitration. For its part, the Czech Republic predicts a "token" amount of compensation will be awarded, while Saluka is claiming as much as \$1.7 Billion (US).

The dispute traces its roots back to the (then) Czechoslovakia's privatization of its banking sector in the 1990s, and an investment by Saluka's parent corporation in a 46.16% stake in Investicni a Postovni Banka (IPB), one of four banks which were privatized at that time. All four banks faced a high-number of non-performing loans, coupled with a legal system that hampered efforts to enforce debt payment.

Following a string of bank runs in 2000, IPB was placed under forced-administration and ownership was quickly transferred to a competitor. It's an outcome which Saluka alleges would have been avoided if the Czech Republic had provided financial aid to the ailing bank – aid which the other three big banks received.

During deliberations on jurisdiction, the Czech Republic had countered that Saluka's claim was ineligible under the Czech-Dutch bilateral investment treaty because Saluka was not a bona fide investor in IPB.

The Czech authorities argued that Saluka was a mere "shell" of London-based Nomura Europe, with no genuine social or economic links with The Netherlands.

The arbitral tribunal would reject this argument, pointing to the relevant treaty's broad definition of who qualified as a covered "investor". As the tribunal reminded the Czech Republic, the treaty contained no language which would exclude holding companies such as Saluka from enjoying the treaty protections.

Notably, the tribunal allowed that it had "some sympathy for the argument that a company which has no real connection with a State Party to a BIT, and which is in reality a mere shell company controlled by another company which is not constituted under the laws of that state, should not be entitled to invoke the provisions of that treaty."

"Such a possibility", the tribunal went on to note, "lends itself to abuses of the arbitral procedure, and to practices of 'treaty shopping' which can share many of the disadvantages of the widely criticized practice of 'forum shopping'."

Yet, having expressed this sympathy with the Czech Republic's arguments, the tribunal noted that it was bound to apply the terms of the treaty which had been negotiated (some years earlier) by the Czech Republic and the Netherlands, and that treaty contained a very capacious definition of "investor", one which permits investors from third countries to shelter under the treaty's protective canopy by virtue of mere incorporation in either the Czech Republic or the Netherlands.

The tribunal would also reject a second jurisdictional objection raised by the Czech Republic, namely an assertion that the company had acted “fraudulently and dishonestly” in its dealings with Czech authorities.

The Czech side had objected to the “circular” financial arrangements which led Nomura to acquire two Czech breweries held by the IPB bank. These breweries, not the bank itself, were Nomura’s true goal, according to the Czech Republic. Had the Czech authorities known about this objective - which they claim they would have if Nomura had submitted a more forthright business plan - they would not have accepted the company’s bid for IPB.

The tribunal would reject this argument by the Czech Republic, noting that a business plan is a rather imprecise document, and does not necessarily demand disclosure of long-term objectives of this sort.

Moreover, the tribunal pointed out that the shares were purchased by Nomura, before being transferred to the Dutch-based Saluka. Stressing that Nomura and Saluka are separate legal entities - and not interchangeable – the tribunal added that if there was any illegality in the way the shares were acquired, it would be attributable to Nomura, rather than its Dutch-subsiidiary, Saluka.

Empowered to consider Saluka’s claims on their merits, the tribunal would go on to find the Czech Republic to be in breach of Article 3 of the Czech-Dutch BIT on Fair and Equitable Treatment, but not of Article 5, on Deprivation (or expropriation).

In effect, the Czech Republic was declared to be well within its regulatory powers to place IPB under forced administration given the bank’s precarious financial state and the government’s responsibility to respond. However, the treatment Saluka received from Czech authorities in the run-up to the forced administration was held to be in breach of the Fair and Equitable Treatment requirement in the treaty.

For one, the tribunal held that Saluka should have been offered greater financial assistance from the Czech Government. Such state aid was offered to its competitors, and as a bank of similar size and economic importance, denying this help to IPB was discriminatory.

The tribunal also found that Czech authorities in the Finance Ministry unfairly rejected proposals put forth by Nomura, refusing at times to meet with the company’s representatives. Ministry officials clearly favoured transferring IPB to Ceskoslovenska Obchodni Banka (CSOB), and shut out other options favoured by Nomura, according to the tribunal’s ruling.

The tribunal, consisting of Sir Arthur Watts (Chairman), Maitre L. Yves Fortier, and Professor Peter Behrens, will now conduct a hearings on damages.

However, there remains a possibility that either party to the arbitration could choose to challenge the partial award on liability by turning to the courts of the place of arbitration, in this case Switzerland.

In the mean time, Czech politicians have been busy massaging public concern about the potential financial liabilities of the Government. In particular, the Czech Government harbours the hope that a separate arbitration brought by the Czech Republic against Saluka's parent firm, Nomura - and which is currently in hearings this month - could see the Czech Republic recoup substantial damages from Nomura.

The parallel arbitration, which was launched in 2002 under the share purchase agreement which gave Nomura its shares in IPB, involves a claim for anywhere from 4 to 8 Billion Dollars (US). The Czech Government alleges that it has suffered such losses as a result of Nomura's breach of the share purchase agreement, the forced administration of the IPB bank, and for the subsequent indemnifications which the Czech state had to make to another bank (CSOB) which ultimately took over the failing IPB franchise.

2. ANALYSIS: Tribunal distinguishes regulation from expropriation in latest Czech case, By Luke Eric Peterson

Of all the Governments of Europe, the Czech Republic has a strong claim to having had the most experience of investment treaty disputes. Depending upon which government official you ask, the Republic has faced anywhere from 10 to 14 claims, not all of which have blossomed into formal arbitrations as yet.

Already, the Republic has prevailed in an investment treaty arbitration with a UK investor, William Nagel, over a disputed cellular telecommunications bid. But, more notable, the Republic also lost a major arbitration in 2001 with the Dutch broadcasting firm CME, and was later obliged to pay out more than \$350 Million US in damages. This ruling came in spite of the fact that the Republic prevailed in a companion arbitration which had been launched in parallel by the major shareholder of that same Dutch broadcasting firm.

The CME outcome galvanized the attention of Czech politicians and the media, leading to an unusual amount of domestic scrutiny of the country's adherence to (hitherto obscure) international investment treaties. Hardly a week goes by now without discussion in the Czech press of the myriad international arbitrations faced by the Republic.

Predictably, there have been cries from some political factions for the Czech Government to amend - or abrogate altogether - the treaties which were signed in large volumes in earlier years.

The current Administration acknowledged recently that it is seeking to change the terms of certain of these treaties - for example to eliminate coverage for indirectly-held

investments. That proposal would close a loophole which can permit foreigners to incorporate investment vehicles in a third country, and to use that vehicle to invest into the Czech Republic, yet retain the right to bring an indirect claim against the host country, by invoking the a treaty signed between the host country and the investor's actual home country.

For example, a US investor could incorporate a subsidiary in the Dutch West Indies, and use that vehicle to make investments in the Czech Republic, thereby opening up the option of bringing a direct claim against the Czech Republic under the Dutch-Czech BIT, at the same time as the US investor retained a right to bring a so-called indirect claim under a US treaty with the Czech Republic for damages suffered by the US investor's Dutch subsidiary operating in the Czech Republic.

Of course, changes to treaty provisions require that the Czech Republic obtain the consent of its treaty partners – something which is not always forthcoming.

As new members of the European Union, the Czech Republic has also signaled that it would like to terminate its investment treaties with fellow EU member-states such as the United Kingdom or the Netherlands. These treaties account for the large share of investment arbitrations faced by the country, and Czech Finance Ministry officials insist that future investment disputes with EU companies or investors can be governed by EU treaties and law. Any resulting adjudication would take place in (open) European courts, rather than before (closed) international arbitration tribunals.

While the Czech Government ponders the future of its international investment treaties, and what steps to take in its arbitration with Saluka (see accompanying story), it may draw some consolation from the recent arbitral ruling in the Saluka dispute. While the Republic was found liable for breach of certain provisions of the Dutch-Czech BIT, the arbitral tribunal did endorse a central plank of the Czech Republic's defence, namely that the country was not liable for expropriation of Saluka's investments in the Czech bank IPB.

Indeed, the tribunal ruling will be of some interest to policy-makers in other countries because it offers another endorsement of the so-called "police powers" rule under international law. For almost a decade, there has been debate in international investment law circles as to whether public welfare regulation by a government will violate investment treaty provisions on expropriation, thus triggering the obligation to compensate affected foreign investors for their losses.

However, with its recent award, the Saluka tribunal offers a strong affirmation of the "police powers" rule: holding that a state has not committed an expropriation "when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulations that are aimed at the general welfare."

In reaching this conclusion, the tribunal also smiled upon the separate conclusion of another recent arbitral ruling in a closely-watched dispute between the Canadian-based

Methanex Corporation and the US Government under the investment chapter of the North American Free Trade Agreement. The tribunal in the Methanex case had been convened to adjudicate an investor claim for compensation arising out of a public health ban placed by the state of California on a controversial gasoline additive.

In its much-anticipated award in August of 2005, the Methanex tribunal would rule that the California measures were not equivalent to expropriation, adding that “where economic injury results from a bona fide regulation within the police powers of a State, compensation is not required.”

(Disclosure: the IISD, publishers of the Investment Treaty News service, were not disinterested observers in the Methanex case; a legal team hired by the IISD had filed a legal brief in that arbitration. For more on that effort, click [here](#).)

3. ICSID Member-Governments OK watered-down changes to arbitration process, By Damon Vis-Dunbar and Luke Eric Peterson

A package of seven amendments to the rules and regulations of the Washington-based International Centre for the Settlement of Investment Disputes (ICSID) – the most popular venue for investment treaty arbitration - have been approved by an overwhelming majority of the Centre’s member governments.

According to sources, the ICSID Administrative Council – consisting of representatives from each of the 143 states which have ratified the ICSID Convention – has voted in favour of the amendments by an overwhelming margin.

The deadline for votes passed on February 24.

The amended rules, seen by Investment Treaty News, have been reworked several times since the ICSID Secretariat first floated the idea of procedural reform in October of 2004, in a paper titled “Possible Improvements of the Framework for ICSID Arbitration.” Following consultations with a range of member-governments, as well as stakeholders in the business, legal and civil society community (including the publishers of Investment Treaty News), a revised series of proposals were released in May of 2005.

Most notably, an earlier proposal for a centralized appeals facility, which would have had the authority to review investment arbitration awards, was discarded. In an explanatory note, ICSID officials noted that many commentators viewed the proposal for an international appeals facility as “premature.”

The revised proposals were presented for further public comments, after which a second series of revisions were to be made to the proposals before they would be tendered to ICSID member-governments for approval.

Voting on the proposals took place in late 2005 and early 2006; however, the text being voted upon was not released to the public at this time.

Recently, Investment Treaty News obtained a copy of the proposals which were distributed to all ICSID member-governments. The final proposals differed in some key respects from the last version of reforms which had been tendered for public comment in May of 2005.

Notably, a proposed amendment to open up arbitration hearings has been watered down significantly.

In 2005, a proposed amendment to ICSID arbitration rule 32 would have handed the tribunal greater discretion to open hearings to the public. The proposed rule read as follows at that time:

"After consultation with the Secretary General, and with the parties as far as possible, the tribunal may allow other persons ... to observe all or part of the hearings"

However, following further public consultations, the proposal which was presented to member-governments for a final vote read as follows:

"Unless either party objects, the Tribunal, after consultation with the Secretary-General, may allow other persons ... to observe all or part of the hearings."

Prof. Christoph Schreuer, a professor of international law at the University of Vienna, and an expert on the ICSID system, observes that the new rule continues to provide parties with an effective veto over the opening of arbitral proceedings to non-parties. By contrast, the original proposal championed by the ICSID Secretariat - but nixed during consultations with the public and member-governments - would have removed such a veto.

As a result, the final change appears to do little to alter the actual substance of the current Rule 32 of the arbitration rules, which provides that hearings may be opened to the public, subject to the consent of the parties to an arbitration.

The change between the old rule and the revised one is "hardly a big difference," says Prof. Schreuer of the University of Vienna. Under the existing approach, the parties' consent is needed before third parties can gain attend oral hearings. In future, each party continues to enjoy a right to veto such open hearings.

Apart from the changes to the ICSID rules on open hearings, the new ICSID rules introduce other changes to the ICSID arbitration process, including a requirement that the Centre promptly publish excerpts of the legal reasoning of its arbitral tribunals.

While this rule-change does not give the Centre the unilateral right to publish arbitral awards in their entirety, it does bid ICSID to move swiftly to publish the relevant

portions of such awards. As before, the consent of both parties to the arbitration is needed before the award can be published by ICSID in its entirety. This obstacle does not preclude a single party from publishing an award on its own, for example on the World Wide Web or through a legal reporting service.

The new ICSID rules also introduce a requirement that any requests by arbitrators for a fee higher than the rate agreed at the outset of an arbitration, should be tendered to the Secretary-General of ICSID, rather than to the parties to that arbitration.

This change is designed to alleviate the pressure which some parties may feel when confronted with requests from the presiding arbitrators for a hike in their fees. Investment Treaty News is aware of an ongoing ICSID arbitration where a respondent government has made clear to the Centre that it felt pressured into accepting a demand made by an arbitrator for a higher fee.

The new rules, which have yet to be made public – but which have been seen by ICSID member-governments - are expected to come into effect by mid-year.

Sources:

“Detailed ICSID amendments tabled, openness pondered, appeals facility nixed”, By Bonnie R. Penfold, INVEST-SD, June 10, 2005

“ICSID Secretariat floats proposals for reforms to investor-state arbitration” By Luke Eric Peterson, INVEST-SD, October 27, 2004

ICSID Discussion Paper of proposed reforms, October 2004, available by clicking [here](#).

Revised ICSID reform proposals, May 2005, available by clicking [here](#).

4. US oil firm loses BIT claim against Trinidad & Tobago, By Luke Eric Peterson

A Texas-based energy company, FW Oil, has lost a claim lodged against the Government of Trinidad & Tobago for alleged breach of the US investment protection treaty with the Caribbean nation.

According to press reports, the US firm failed to convince the presiding arbitral tribunal that it had an “investment” as defined under the terms of the relevant BIT.

FW Oil had claimed that it was awarded a contract for rehabilitation and exploration of oil and gas fields located off of Trinidad’s south-west coast, but that this contract was subsequently revoked several months later. For its part, the Government denied that a contract was in place with the US investor.

A three-member arbitration tribunal consisting of Fali S. Nariman, Sir Franklin Berman and Lord Michael Mustill rendered its award on March 3rd, rejecting FW Oil's claims. The parties have not released that award to the public.

Excerpts of the award published in the Trinidad & Tobago press suggest that the US investor had alleged that it was the victim of state corruption by a former Government minister and by state officials. However, evidence to bear out these assertions was not tendered to the tribunal, and in some press reports suggest that the corruption allegations were withdrawn at a late stage in the proceeding.

ITN will continue to monitor developments in this case. Under ICSID rules, the investor has 90 days in which to request revision of the award or 120 days in which to seek annulment of the award.

5. Italians drop human rights claim against Georgia, initiate investment treaty claim, By Luke Eric Peterson

Two Italian investors, Ares International S.r.l. and MetalGeo S.r.l., have seen their international claim against the Republic of Georgia registered by the International Centre for Settlement of Investment Disputes (ICSID). The pair alleges that the Georgian Government has expropriated their investment in a privatized metallurgical complex in the city of Rustavi.

After signaling their intention to pursue a claim against Georgia at the European Court of Human Rights in Strasbourg, the investors changed course last year and elected to arbitrate under the Italy-Georgia bilateral investment treaty (BIT).

The Italian firms allege that the administration of President Mikhail Saakashvili - which came to power in the aftermath of the mass protests which unseated long-serving President Edward Shevardnadze - proved unremittingly "hostile" towards their interests, and dedicated itself to "expelling the claimants from Georgia".

Following the change in administration, the investors allege that their share purchase agreement signed with the previous government was annulled in an irregular series of legal proceedings, and due to pressure by Mr. Saakashvili's Government.

The investors argue that they have suffered an expropriation contrary to Georgia's treaty obligations, as well as a denial of fair and equitable treatment as guaranteed under the treaty. Furthermore, they allege that Most-Favoured Nation clause of the Italy-Georgia BIT also entitles them to the "full protection and security standard" contained in another BIT signed by Georgia with the United Kingdom.

Their arbitration claim was registered by the ICSID in November of 2005 and a tribunal

had not been fully constituted at press time.

6. ICSID Committee rejects request for annulment in R.F.C.C. v. Morocco,
By Damon Vis-Dunbar

An ad-hoc committee of the of International Centre for the Settlement of Investment Disputes (ICSID) has rejected an annulment request submitted by an Italian construction firm alleging breaches of the Italy-Morocco bilateral investment treaty.

R.F.C.C. Morocco, an Italian consortium, brought a claim to ICSID after a contract with a Moroccan state-owned company to build a stretch of highway was terminated.

The dispute bears close similarities to another ICSID case, Salini Costruttori S.p.A. v. Morocco, in which another Italian construction firm claimed breach of the Italy-Morocco investment treaty when the firm's contract to build a highway was also canceled.

The same three member tribunal was appointed in the Salini and R.F.C.C. matters, and in both cases the tribunal upheld jurisdiction to consider alleged breaches of the treaty. These jurisdictional decisions were notable, as they addressed whether a tribunal constituted under an investment treaty has jurisdiction to hear alleged breaches of an investment contract with a state company.

The Salini case was later settled before the tribunal reached a determination on the merits of the dispute; however, in an award rendered in December of 2003, the tribunal dismissed R.F.C.C. Morocco's claims on their merits.

R.F.C.C. Morocco filed for annulment of the award, in accordance with an often-used ICSID procedure. Following the issuing of a ruling by an ad-hoc annulment committee in the annulment proceeding – rejecting the investor's claims – the Moroccan firm requested that the committee's decision not be released to the public.

Sources:

“Investment Treaty Dispute with Morocco Heading to Annulment Phase”, By Luke Eric Peterson, INVEST-SD, May 11, 2004

“Investor Loses Investment Treaty Case Against Morocco”, By Luke Eric Peterson, INVEST-SD, January 23, 2004

Negotiation Watch:

7. US and Pakistan struggle to settle differences on investment treaty,

By Damon Vis-Dunbar

A US-Pakistan bilateral investment treaty (BIT) faces an uncertain future following the failure to conclude the deal during the US president's visit to Islamabad earlier this month.

Pakistan was under heavy pressure to wrap-up the agreement prior to President George Bush's visit in March. Lengthy negotiations were held in the weeks and days leading up to the US president's visit, but to no avail.

Among the sticking points was the opening up of financial services in Pakistan to US investors. Currently, US investors are limited to a 51 per cent equity share in banks and insurance, and a 60 per cent equity share in corporate farming. The US is said to be pushing for greater amounts. These are some of the only sectors with foreign ownership restrictions in Pakistan; investment in infrastructure and social services such as health and education are fully open to foreigners.

Pakistan has also expressed concerns about and proposals to include intellectual property (IP) as a category of protected investment under the agreement. It is feared that including IP under the list of protected investments may allow US investors to sue for breach of the investment treaty, if it is felt that Pakistani authorities are not doing enough to police the illicit production of copyrighted material in an effective manner.

Although the US has praised Pakistan in recent months for its efforts to clamp down on pirated music and videos, it remains a problem.

Some two-years in the making, the proposed investment treaty has received a great deal of public attention in Pakistan, with speculation on the state of the negotiations a common fixture in the Pakistani press.

Negotiations with the United States Trade Representative are being handled by the Pakistani Board of Investment (BOI), with input from the Attorney General's office, the Finance Ministry and a number of outside advisors.

By all accounts, the Pakistani government appears split. While President Pervez Musharraf is said to be pushing for an agreement to be concluded quickly, the Attorney General's office is hesitant, given its more intimate experience with a number of expensive cases of international arbitration with foreign investors.

Meanwhile, the Pakistani Finance Ministry views the BIT as a stepping stone to a free trade agreement, one that opens the US market to Pakistani textiles.

President Bush's visit was "a golden opportunity," said one official in the Pakistani finance ministry, who expressed concern that the BIT's future was now in doubt.

Indeed, sources say that without a commitment by the US to launching FTA talks,

Pakistan will be reluctant to make concessions on an investment treaty.

However, given the difficulty the US administration had in getting Congress to pass the recent Central American Free Trade Agreement in Congress, and the powerful US textile lobby, US officials are clearly reluctant to commit to an FTA with Pakistan.

An official with the Finance Ministry said that the US had suggested an FTA that excluded textiles; however, this official noted that such an agreement would mean little to Pakistan given that nearly 90 per cent of the country's exports to the US are in textiles.

Sources:

ITN interviews

“Pakistan moving toward investment treaty with United States”, By Damon Vis-Dunbar, INVEST-SD, October 4, 2006

8. Canada, Mexico and US to look at how new FTAs may improve NAFTA practice,
By Luke Eric Peterson

At a meeting last week, Trade Ministers from Canada, Mexico and the United States announced that they will examine “how elements of new FTAs (Free Trade Agreements) might inform improvements to NAFTA practices such as transparency and trade facilitation.”

The Ministers instructed national-level officials in the three countries to report in six months time on these issues.

A spokesperson for Canada's Department of Foreign Affairs and International Trade offered little elaboration on this ministerial statement when contacted by ITN.

“There are no plans to reopen the NAFTA to ‘update’ specific articles,” said the spokesperson. Rather, the three Governments will “review best practices in other FTAs” and draft proposals which will be debated when Ministers meet again in late 2006 in Canada.

It remains unclear if the review will focus on Chapter 11 of the NAFTA, as the Ministers have already made strides in introducing transparency to the investment arbitration process under NAFTA through public statements affirming their commitment to openness.

Still, it remains possible, in theory, for claimant-investors under NAFTA to decline to allow arbitral hearings to be opened to the public. By contrast, new negotiating templates introduced by the US and Canada in recent years, and used as the basis for a number of recent trade and investment agreements, stipulate that all investor-state arbitrations will

be opened to the public.

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