



Litigating Intellectual Property Rights in Investor-State Arbitration: From Plain Packaging to Patent Revocation

by Henning Grosse Ruse-Khan



7

TRANSATLANTIC TRADE
AND
INVESTMENT PARTNERSHIP



9



In Accordance with *Which* Host State Laws? Restoring the ‘Defence’ of Investor Illegality in Investment Arbitration

by Jarrod Hepburn

Who is Afraid of Investor-State Arbitration? Unpacking the Riddle of ‘No Greater Rights’ in the TTIP

by Jan Kleinheisterkamp

China’s New Outward Investment Measures: Going Global in a Sustainable Way?

by Joe Zhang

UNCTAD Multi-Stakeholder Meeting Seeks Reform of Investment Treaties and Investment Dispute Settlement

by James Zhan and Diana Rosert

Also in this issue: Yukos shareholders awarded record damages in two separate proceedings against Russia; ICSID committee declines to annul award finding breaches of fair and equitable treatment obligation by Argentina

contents

3 Features

Litigating Intellectual Property Rights
in Investor-State Arbitration: From Plain
Packaging to Patent Revocation
Henning Grosse Ruse-Khan

7 In Accordance with Which Host State Laws?
Restoring the 'Defence' of Investor Illegality
in Investment Arbitration
Jarrod Hepburn

9 Who is Afraid of Investor-State Arbitration?
Unpacking the Riddle of 'No Greater Rights'
in the TTIP
Jan Kleinheisterkamp

11 China's New Outward Investment Measures:
Going Global in a Sustainable Way?
Joe Zhang

13 UNCTAD Multi-Stakeholder Meeting
Seeks Reform of Investment Treaties and
Investment Dispute Settlement
James Zhan and Diana Rosert

15 **News in Brief:**
New European Commissioners suggest that
ISDS may be shut out of the TTIP; Some EU
governments oppose ISDS in CETA, despite
recently concluded negotiations

16 **Awards and Decisions:**
Hulley Enterprises Limited (Cyprus) v. The
Russian Federation; Yukos Universal Limited
(Isle of Man) v. The Russian Federation;
Veteran Petroleum Limited (Cyprus) v.
The Russian Federation; OAO Neftyanaya
Kompaniya Yukos v. Russia; El Paso Energy
International Company v. Republic of
Argentina

23 **Resources and Events**

Investment Treaty News Quarterly
is published by
The International Institute for
Sustainable Development
International Environment House 2,
Chemin de Balexert, 5th Floor
1219, Chatelaine, Geneva, Switzerland

Tel +41 22 917-8748
Fax +41 22 917-8054
Email itn@iisd.org

Executive Director - International Institute for
Sustainable Development - Europe
Mark Halle

Programme Manager
– Investment for Sustainable Development
Nathalie Bernasconi

Editor-in-Chief
Damon Vis-Dunbar

French Editor
Suzy Nikiema

French Translator
Isabelle Guinebault

Spanish Editor
Marina Ruete

Spanish translator
Maria Candeli Conforti

Design:
The House London Ltd.
Web: www.thehouselondon.com

Litigating Intellectual Property Rights in Investor-State Arbitration: From Plain Packaging to Patent Revocation

Henning Grosse Ruse-Khan

feature 1



Enforcing intellectual property (IP) rights abroad is a difficult enterprise. International IP treaties have generally not created global, directly enforceable IP rights. Usually, the protection they confer cannot even be directly invoked in front of national courts. Rather, because of the territorial nature of IP protection, right holders must enforce their rights in local courts based on local laws. Litigating one's IP rights abroad hence faces significant hurdles.

International investment law may offer some options to overcome these hurdles: international investment agreements (IIAs) commonly include IP rights in their protection for foreign investments against government interference. Moreover, under IIAs investors can often directly challenge host state measures in international arbitration proceedings. Relying on investment standards therefore offers right holders an alternative mechanism to protect their IP rights abroad. And unsurprisingly, IIAs are increasingly used to challenge the host state's compliance with international IP treaties.

In one of these cases, the tobacco company Philip Morris argues its trademarks have been expropriated by Australia's tobacco packaging controls. In another, the American pharmaceutical giant Eli Lilly is invoking investment standards under Chapter 11 of the North American Free Trade Agreement to challenge Canadian court decisions that revoked some of its key patents.¹ In both cases, the investor invokes legitimate expectations that the host state complies with international IP treaty norms. In the award *AHS vs Niger*, however, arbitrators have denied their competence to rule on alleged breaches of an international IP agreement.²

Compared to domestic proceedings (where international IP standards usually cannot be invoked), World Trade Organization dispute

settlement (where right holders have no legal standing), and the protection of property under human rights instruments (where protection is limited to the specific human rights standards), investor-state arbitration under IIAs may be the only forum where right holders can attempt to litigate international IP norms such as those in the TRIPS Agreement. This in turn may have significant effects on the regulatory autonomy of host states in responding to public interest concerns (such as enhancing access to medicines or reducing smoking) once domestic measures affect IP rights of foreign investors.

This brief article reviews the options for litigating international IP norms in investment disputes in light of current cases, and concludes that most routes pursued by right holders are unlikely to be successful. Ironically, it is only the clauses in investment treaties which aim to safeguard flexibilities in the international IP system that are likely to open a door for challenging compliance with international IP obligations in investor-state arbitration.

IP rights in current investor-state arbitration cases

In 2011, Australia introduced the Tobacco Plain Packaging Bill, which

(1) requires tobacco product packaging to be drab dark brown or other prescribed colour; and

(2) prohibits the use of graphic trademarks and restricts the use of word marks on tobacco product packaging to the effect that the brand, business, company or variant name may be displayed only in certain standard styles and positioning on the packaging.³

The rules aim to reduce the attractiveness and appeal of tobacco products to consumers, increase the noticeability and effectiveness of mandated health warnings, and reduce the ability of the tobacco product and its packaging to mislead consumers about the harms of smoking. In response, Philip Morris Asia (PMA), based in Hong Kong, initiated investor-state arbitration proceedings against the Australian Government under the Hong Kong-Australia BIT.

PMA argues that plain packaging turns tobacco products into a commodity, prevents it from distinguishing its products from competitor brands, and thereby substantially diminishes the value

of PMA's investments in Australia. One of its key claims is that Australia is in breach of the BIT because plain packaging breaches international trademark rules in the Paris Convention for the Protection of Industrial Property (PC) and WTO Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS). Relying primarily on the fair and equitable treatment (FET) standard, PMA claims a "legitimate expectation that Australia would comply with its international trade treaty obligations", in particular under TRIPS and the PC.⁴ PMA also argues that the umbrella clause in the Hong Kong-Australia BIT requires Australia to observe, as an obligation it has entered into with regard to investments of protected foreign investors, compliance with "international obligations binding on the host state that affect the way in which property is treated in Australia."⁵ According to PMA, these obligations include those deriving from international IP treaties such as TRIPS and the PC.⁶

As mentioned, another IP-related investment dispute concerns the US-based pharmaceutical company Eli Lilly which in November 2012 initiated investor-state arbitration proceedings under Chapter 11 of NAFTA against Canada following the invalidation of some of its pharmaceutical patents by Canadian courts.⁷ At the centre of the dispute is a 'promise doctrine' whereby Canadian courts take for granted what the patent application has described as useful effect of the invention and hold the applicant responsible for fulfilling this 'promise' of utility. If the patented invention later is found not to meet a promise the court has constructed from the patent application, the patent can be revoked. Eli Lilly complains that the strict patentability requirements resulting from this doctrine, as applied by the Canadian Courts since 2005, violate Canada's international IP obligations under NAFTA, TRIPS and the Patent Cooperation Treaty (PCT). This in turn, Eli Lilly argues, breaches NAFTA's investment chapter since "Canada has a positive obligation to ensure Canadian law complies with NAFTA and the PCT, consistent with the reasonable investment-backed expectations of the investor."⁸

Similar to the plain packaging dispute, the investor relies on the FET (and here also on expropriation) standard to claim a legitimate expectation that the host state complies with international IP norms. In *Lilly vs Canada* however, a specific NAFTA clause safeguards flexibilities in international IP law by ensuring that the expropriation standard does not apply to certain IP limitations such as compulsory licenses or revocations of IP rights as long as these limits are consistent with international IP rules.⁹ This clause, which is also present in a range of other

BITs, explains why Eli Lilly puts so much emphasis on a breach of these rules: unless Eli Lilly can make a case that Canada's measures are in breach of international IP law, Eli Lilly is effectively barred from relying on one of its strongest arguments—the detrimental legal and economic effect the revocation has on Eli Lilly's patents and their exploitation. In order to keep the door open for these expropriation arguments, Eli Lilly first has to show a breach of Canada's IP obligations. Next to FET and umbrella clauses, these safeguard clauses hence serve as another 'door opener' to litigate compliance with international IP law in investor-state arbitration. As discussed below, most-favoured nation (MFN) clauses in BITs could also be understood to cover IP protection under TRIPS or other IP treaties as 'more favourable treatment' the host state owes to an investor. Although not relied upon in the current cases so far, MFN clauses hence may provide yet another avenue for investors to invoke international IP obligations between states.

What is the appropriate role for international IP rules in investor-state arbitration?

The full version of this article contains a detailed review of the four options for right holders to litigate international IP norms in investor-state arbitration. Three of these options are based on an expansive reading of traditional elements of the investment protection regime such as legitimate expectations under FET and expropriation standards, umbrella clauses and the MFN principle. However, none of these three options is likely to be successful. While generalisations are difficult in investor-state arbitration, analysing the case of plain packaging in Australia and patent revocation in Canada reveals high hurdles for investors:

- (1) To the extent one accepts the notion of legitimate expectations as part of FET or the expropriation standard, the grant of a *domestic IP right* by the host state as such does not allow the investor to legitimately expect his right to be free from measures commonly used to limit IP exclusivity (such as compulsory licenses or options for revoking patents).
- (2) Leaving aside jurisdictional issues about the exclusive competence of the WTO dispute settlement system to rule over breaches of TRIPS, an investor can only expect host state compliance with *international IP rules* if these rules are
 - a) directly applicable as part of the domestic law;
 - b) sufficiently concrete to be applied by domestic institutions; and

c) give rise to individual rights of the investor.

Based on these criteria, it seems unlikely that most international IP norms can be invoked by right holders in investment disputes.

(3) Umbrella clauses—even if drafted in broad terms and not limited to specific commitments made by host states—have so far not been held as extending to obligations the host state has entered into vis-à-vis other states in international law. Neither the intention of the IIA state parties, nor the underlying *pacta sunt servanda* rationale for umbrella clauses supports an application which would allow right holders to rely on such clauses to claim a breach of international IP treaties in investor-state arbitration.

(4) Finally, MFN rules in international investment agreements (IIAs) also cannot be applied to incorporate IP protection under TRIPS or other international IP treaties as a form of 'more favourable treatment' to foreign investors. Based on the *ejusdem generis* principle, the differences in subject matter and standards of protection between IP and investment law stand against the inclusion of specific international IP protections via an IIA MFN rule. The wording of the relevant MFN clauses in the plain packaging and patent revocation disputes confirms this.

Ironically, therefore, the most promising route for right holders to invoke breaches of international IP norms in investment disputes is based on clauses that aim to safeguard flexibilities in the international IP system. As Eli Lilly's complaint about Canada's breaches of TRIPS, NAFTA and the PCT shows, the consequence of these 'safeguard clauses' (such as Art.1110:7 NAFTA in *Lilly vs Canada*) is that consistency with international IP norms is tested in investor-state arbitration. In the context of TRIPS, this raises questions about the legitimacy and acceptance of any decisions on TRIPS compliance rendered by investment arbitration tribunals in light of the competing jurisdiction under the WTO dispute settlement system. If a similar safeguard clause existed in the Hong Kong-Australia BIT, should the plain packaging arbitrators defer in their decision on Australia's compliance with TRIPS to findings made by the WTO Panel charged with that dispute? Should investment arbitrators rather wait until the WTO Appellate Body has had its final say on the matter, or should they refrain from judging on TRIPS consistency altogether? What if on the

other hand arbitrators in the patent revocation case make findings about a breach (or not) of NAFTA's IP Chapter or the equivalent TRIPS patentability standards? Would such a finding affect any future WTO or NAFTA dispute brought by, for example, the US against Canada? Arguably there is no binding precedence, but it is hard to imagine that a decision made in either of the systems would not have an effect on the other forum.

On the other hand, the institutional and normative framework within which a dispute is decided matters. Next to questions of subject matter expertise and secretarial support, differences in allocating the burden of proof and determining the appropriate 'normative environment' for interpreting and applying IP provisions are likely to lead to distinct outcomes. In particular where the IP treaty does not have its own specific dispute settlement system, investment decisions on IP matters enjoy a de facto precedence-setting character. But should the outcome really be a matter of which forum gets to decide?

The challenging question for governments is: what are the alternatives to clauses safeguarding TRIPS flexibilities? A first step may be a clarification ensuring that inconsistency with TRIPS is not sufficient to establish expropriation. One could go further and substitute the TRIPS consistency test with one that focuses on traditional investment standards, such as denial of justice or an abuse of right.¹⁰ The latter would avoid the problems linked to competing decisions on the same set of international rules. However, it would not prevent investment arbitrators from regarding international IP rules based on applicable law rules in IIAs, the *lex arbitri* or on general international law doctrines. Even if not directly applicable, TRIPS and other international IP norms may serve as relevant interpretive context, in particular under Art.31 (3) c) VCLT which—as customary rule of treaty interpretation—allows for relevant rules of international law to be taken into account: As soon as both parties to the IIA are members of the WTO, the Paris or Berne Union, provisions of those treaties that more specifically bear upon a host state measure affecting IP rights as protected investments may be considered as "relevant rules of international law applicable in the relations between the parties". As a form of *lex specialis* for the protection of IPR related investments, international IP norms hence may affect the interpretation of investment standards.

Conclusion

I have argued that none of the three attempts to use expansive readings of traditional investment

standards like FET and expropriation, umbrella clauses and MFN are likely to be successful to invoke international IP obligations in investor-state arbitration. After all, these obligations agreed between states are owed only to states, not to private parties—even if they enjoy specific international protections as foreign investors. As long as these specific protections do not explicitly extend to international IP rules, one can hardly assume a state consent for expanding general concepts like legitimate expectations or MFN to cover a distinct body of international law.

Ironically, clauses specifically safeguarding flexibilities of the international IP system can lead to litigation over the host state's compliance with these IP norms. Current discussions in the context of the trade agreement between the EU and Canada show how disputed these clauses are today. Alternatively, general international law doctrines are readily available to fulfil the tasks of specific safeguard clauses—without the 'side effect' of allowing investors to challenge compliance with international IP treaties in investor-state arbitration. Interpretation based on Art.31 (3) c) VCLT of course also allows investors to claim that investment standards are to be understood in light of IP norms which the investor may allege to have been breached by the host state. For example, *Eli Lilly* could claim that the revocation of its patents by Canadian courts amounts to an expropriation under NAFTA Ch.11 *because* the latter has to be understood in light of both TRIPS and the NAFTA Ch.17 rules on patent revocation and utility as a condition for patentability. Arbitrators examining this claim would arguably also form their view on what these international IP standards entail and whether Canada's court decisions are consistent with them. However, that does not mean that arbitrators are directly applying these standards and judging on Canada's compliance. Based on interpretative norms in the VCLT, consistency with international IP norms merely feeds into the principal analysis of the expropriation standard—as one of several factors.¹¹

The main downside of relying on general international law doctrines is the legal uncertainty that comes along with it: arbitrators may not consider IP norms as 'relevant rules' under Art.31 (3) c) VCLT; they may select other ones than those commonly referred to in safeguard clauses or may find their influence on the appropriate understanding of the investment standard not decisive, perhaps in light of other elements of treaty interpretation. It is hard to predict whether these shortcomings weigh heavier than the negative effects of relying on traditional safeguard clauses

described above. Those who draft the next generation of IIAs therefore have to think carefully which approach they prefer in addressing the overlap between international IP and investment rules.

Author

Henning Grosse Ruse-Khan is a lecturer at the University of Cambridge and Fellow at King's College.

Notes

1 See the further discussion in section 2. below and in the full version of the paper, online at <http://ssrn.com/abstract=2463711>.

2 *AHS vs Niger*, ICSID Case No. ARB/11/11, Award of 15 July 2013; further discussed in the full paper.

3 Australian Tobacco Plain Packaging Bill 2011, s 19, 20, 21, 36.

4 *Philip Morris Asia vs. Australia*, Notice of Arbitration, 21 November 2011, at para.6.5 and 7.6-7.11.

5 *Ibid*, at para.7.15-7.17.

6 *Ibid*, at para.7.17.

7 *Eli Lilly and Company vs. Canada*, Notice of Intent, 7 November 2012.

8 *Eli Lilly vs. Canada*, Notice of Arbitration, para.71, 77.

9 See Art.1110:7 NAFTA.

10 See Part II, section 4 of the full article.

11 Next to other interpretative elements such as ordinary meaning, context and object and purpose, BITs sometimes contain a range of general factors that determine whether or not host state measures amounts to an expropriation; see for example Annex A to the 2013 US Model BIT or Art.1110:8 NAFTA.

In Accordance with *Which* Host State Laws? Restoring the ‘Defence’ of Investor Illegality in Investment Arbitration

Jarrold Hepburn

feature 2



Investment treaties are often criticised for being too ‘investor-friendly,’ containing wide substantive protections and broad definitions of their scope, and only rarely containing exceptions clauses. With this in mind, it becomes important to clarify the mechanisms available to host states to defend against investment treaty claims. One such mechanism is found in the provisions included in many investment treaties, to the effect that investors must comply with host state law in order for their investment to enjoy treaty protection. Where states have proven that investors engaged in illegal conduct when making their investment, tribunals have in some cases rejected jurisdiction over the claim—thus providing a weapon for host states to defeat investment treaty claims in appropriate circumstances.

However, despite much recent attention to these ‘investor legality’ clauses, there are several persisting areas of uncertainty in the scope of this ‘defence’ for host states. In particular, certain tribunals have previously proposed limitations on the range of host state laws with which an investor is expected to comply. These limitations could pose obstacles for states seeking to rely on investor illegality to have a claim dismissed.

This article briefly outlines these proposed limitations, and argues that they are unjustified both in terms of their consistency with statements in other cases and their normative desirability.

All host state law, or only the ‘fundamental principles’?

The first proposed limitation stems from suggestions by certain tribunals that investors are not required to comply with *all* of the host state’s law. In the 2006 award in *LESI v Algeria*, the tribunal took the investor legality provisions in the Italy-Algeria bilateral investment treaty (BIT) to mean that investments would lose treaty protection only when made “in violation of fundamental principles in force.”¹ Two awards from 2008, *Desert Line v Yemen* and *Rumeli v Kazakhstan*, followed this view, holding that investor legality only related to breaches of “fundamental principles of the host State’s law.”² Thus, according to these tribunals, it does not matter whether investors have complied with all of host state law, as long as they have complied with the fundamental legal principles of that jurisdiction.

But there are three reasons to doubt whether this position is (or still remains) a justifiable interpretation of investor legality provisions. Firstly, these provisions, as typically worded in investment treaties, make no reference to ‘fundamental principles.’ Instead, they simply require that investments be made ‘in accordance with host state law’ or similar wording.

Secondly, the *LESI*, *Desert Line* or *Rumeli* tribunals were not required to make a finding on whether the investor had complied with host state law.³ This means that their off-hand, *obiter* references to ‘fundamental principles’ carry far less force than if, say, jurisdiction had been accepted despite a clear breach of a regular, non-fundamental host state law.

Thirdly, no other tribunals have appeared to support the ‘fundamental principles’ limitation. Although in most cases the limitation has not been explicitly rejected, where questions of investor legality have arisen, the tribunal has simply not discussed whether or not the relevant law forms part of the host state’s fundamental principles.⁴ Furthermore, in one 2012 jurisdictional decision, *Quiborax v Bolivia*, the tribunal expressly rejected the claimant’s support for a ‘fundamental principles’ limitation, considering that it went “beyond the terms of the BIT, in an attempt to further the investor’s protection without due regard for the State’s interests.”⁵ While the lack of binding precedent in investment treaty arbitration means that the *Quiborax* rejection does not necessarily ‘overturn’ the *LESI/Desert Line/Rumeli* view, it certainly appears that the prevailing doctrinal position is one of scepticism towards the limitation.

Given this, is it possible to re-interpret the comments of the *LESI/Desert Line/Rumeli* tribunals in an effort to make them more consistent with other case-law? In fact, a careful reading of many cases⁶ suggests that investor legality provisions have *two* elements to them. The first element—which might be termed ‘narrow investor legality’—requires compliance with the positive terms of host state law, in its entirety. The second element, by contrast—‘broad investor legality’—additionally requires the investor to comply with fundamental, general principles of law in the abstract, such as good faith, international public policy and prohibitions of fraud, corruption and deceit. This reading can explain why, for instance, the *Inceysa v El Salvador* tribunal declined jurisdiction after finding that the investor had violated principles of good faith, unjust enrichment and international public policy. In fact, the tribunal’s finding of breach of ‘broad investor legality’ was sufficient to decline jurisdiction without examining *Inceysa*’s compliance with positive Salvadoran law.⁷

In this sense, *Desert Line*, *Rumeli* and *LESI* were not wrong to suggest that investments must comply with fundamental legal principles. They were merely under-inclusive, in that investments must also comply with the rest of host state law as well.

One caveat must be applied to this analysis. It is well-accepted that tribunals will not decline jurisdiction merely because the investor has committed a trivial breach of

local law. The minor defect in company paperwork at issue in *Alpha Projektholding v Ukraine*, for instance, did not exclude the tribunal's jurisdiction.⁸ Although, like the 'fundamental principles' limitation, this caveat is not found in investment treaty text either, it has much greater support from tribunals, and also carries a stronger normative justification. States must not be permitted to abuse the technicalities of their own laws to evade investment treaty claims. At the same time, though, a trivial breach is not simply the flipside of breach of a fundamental law: there are, of course, regular laws in the middle of the spectrum. As argued above, there is no reason to exclude the investor's compliance with these laws.

All host state law, or only laws related to investment?

Alongside the 'fundamental principles' limitation, one tribunal has supported a second limitation on the laws with which an investor must comply. In *Saba Fakes v Turkey*, the tribunal commented that Turkey's claim of the investor's non-compliance with domestic competition law and telecommunications regulatory law was irrelevant, because these were not laws "related to the very nature of investment regulation." For the *Fakes* tribunal, the investor legality provision only required compliance with laws "governing the admission of investments in the host State."⁹

Again, though, there is no indication of such a limitation in typical investment treaty text. It is hard to see why an investor should not be required to comply with competition and telecoms laws if these laws affect the entry of new players to a state's telecommunications market. In any case, almost by definition, any law that an investment might potentially breach is surely a law "related to the very nature of investment regulation" —if the law in question does not regulate investment, it seems unlikely that an investment could breach it. The *Fakes* tribunal's comment is therefore puzzling on its face.

Moreover, no other tribunal has considered the subject-matter of the law allegedly breached by an investor to be relevant. In *Anderson v Costa Rica* and *Hamester v Ghana*, the state alleged breaches of domestic criminal laws on fraud—which are, arguably, laws that are not "related to the very nature of investment regulation," since they naturally address a wide range of actors and situations. However, the tribunals in those cases did not suggest that compliance with those laws could be ignored. In *Vannessa Ventures v Venezuela*, where the claimant explicitly relied on the *Fakes* view in its submissions, the tribunal side-stepped the question, finding simply that no Venezuelan laws had been breached.¹⁰ Even in *Fakes* itself, the tribunal was not required to apply its own limitation, since it ultimately found that there was no investment at all.¹¹ Restricting the investor legality requirement only to investment-related laws, then, seems quite unjustifiable.

Conclusion

Compliance with host state law is a crucial part of the investor-state bargain. The investor legality requirement represents one of the few instances where the traditional one-sided nature of investment treaties—imposing many obligations on host states, and few on investors—is

broken. Treaty negotiators are starting to expand on this, with the latest leaked CETA text, for instance, including an explicit provision barring arbitration claims by investors which made their investments through "fraudulent misrepresentation, concealment, corruption, or conduct amounting to an abuse of process",¹² alongside the more usual requirement to invest "in accordance with the applicable [host state] law."

This article contends that a proper interpretation of the legality requirement, as traditionally expressed, would not limit the range of laws with which investors must comply. Rather, the default position must be that investors are obliged to comply with all of host state law, with trivial violations as the only exception. In a context of backlash by states against the investment treaty regime, it is important not to restrict the available defence mechanisms beyond what is permitted by the text, object and purpose of investment treaties.

Author

Jarrold Hepburn is a Lecturer in Law at the University of Exeter, UK.

Notes

¹ *LESI SpA and Astaldi SpA v Algeria* (ICSID Case No ARB/05/3), Decision on Jurisdiction, 12 July 2006 [83].

² *Desert Line Projects LLC v Yemen* (ICSID Case No ARB/05/17), Award, 6 February 2008 [104], also citing *LESI; Rumeli Telekom AS v Kazakhstan* (ICSID Case No ARB/05/16), Award, 29 July 2008 [319].

³ In *Rumeli* it was not clear that the state had alleged any specific breaches of Kazakh law: [169]. In *Desert Line* ([93(c)], [104], [118]) and *LESI* ([83(iii)]), the only relevant issue was whether the investment had met certain formal requirements for recognition in domestic law.

⁴ See, eg, *Saluka Investments BV v Czech Republic* (UNCITRAL), Partial Award, 17 March 2006 [213]–[214]; *Teinver SA v Argentina* (ICSID Case No ARB/09/1), Decision on Jurisdiction, 21 December 2012 [324].

⁵ *Quiborax SA v Bolivia* (ICSID Case No ARB/06/2), Decision on Jurisdiction, 27 September 2012 [263].

⁶ *Phoenix Action Ltd v Czech Republic* (ICSID Case No ARB/06/5), Award, 15 April 2009 [100]–[105]; *Gustav F W Hamester GmbH & Co KG v Ghana* (ICSID Case No ARB/07/24), Award, 18 June 2010 [123]; *Teinver* [317]; *Metal-Tech Ltd v Uzbekistan* (ICSID Case No ARB/10/3), Award, 4 October 2013 [127]; *Plama Consortium Ltd v Bulgaria* (ICSID Case No ARB/03/24), Award, 27 August 2008 [140].

⁷ *Inceysa Vallisoletana SL v El Salvador* (ICSID Case No ARB/03/26), Award, 2 August 2006 [264].

⁸ *Alpha Projektholding GmbH v Ukraine* (ICSID Case No ARB/07/16), Award, 8 November 2010 [297].

⁹ *Saba Fakes v Turkey* (ICSID Case No ARB/07/20), Award, 14 July 2010 [119]–[120].

¹⁰ *Vannessa Ventures Ltd v Venezuela* (ICSID Case No ARB(AF)/04/6), Award, 16 January 2013 [132], [135], [154], [160], [164], [167].

¹¹ *Fakes* [148].

¹² Article X.17.3, Consolidated CETA Text of 1 August 2014.

Who is Afraid of Investor-State Arbitration? Unpacking the Riddle of 'No Greater Rights' in the TTIP

Jan Kleinheisterkamp

feature 3

TRANSATLANTIC TRADE AND INVESTMENT PARTNERSHIP



The Trans-Atlantic Trade and Investment Partnership (TTIP) has been creating expectations and stirring fears ever since it was announced by the former EU Commission President José Manuel Barroso and US President Barack Obama in mid-2013.¹ The promise to boost trans-Atlantic economic exchange in the world's largest free-trade area came along with the aim to "include investment ... protection provisions based on the ... highest standards of protection that both sides have negotiated to date".² This mandate for the EU negotiators is in line with that defined previously by the EU member states for the negotiations of a Comprehensive Economic Trade Agreement (CETA) with Canada, as well as for trade agreements with Singapore and India, all of which shall provide for "the highest possible level of legal protection and certainty for European investors ... built upon the Member States' experience and best practices regarding their bilateral investment treaties". Indeed, with the entry into force of the Lisbon Treaty, it is now for the European Union to legislate on foreign direct investments and therefore also to substitute the 1,500 or so bilateral investment treaties (BITs) that the EU member states have concluded so far with uniform EU agreements with third countries.

The EU member states' BITs are mostly modelled after an OECD blueprint whose origin dates back to 1952. They provide very basic and rather simplistic provisions on investment protection standards, such as national treatment and non-discrimination, fair and equitable treatment and a prohibition on expropriation without adequate compensation. Most notably, the vast majority of these BITs grant foreign investors direct rights of action for damages against their host state before international arbitral tribunals when they feel that the host state has violated the BIT's standards. As for their bilateral or reciprocal character, F.A. Mann noted back in 1981 that reciprocity was "rather a matter of prestige ... than reality."³ The reality is that no BIT has been concluded between two traditional "first world" countries. Historically, in other words, the assumption has been that these treaties would provide for protection to investors from traditional capital exporting countries doing business in countries with poor rule of law records—and poor altogether. In 1965 the World Bank sponsored a multilateral convention for establishing an institutional

framework for these investor-state arbitrations with the official aim to provide for sufficient legal certainty so that investors would not be put off by "political risk" in developing countries, and so as to help these countries to develop.

How, then, does this "development-led" approach square with a deal between the world's two most developed economic blocks? Given the huge size of US investments in Europe and the litigious attitude of US firms and especially law firms, considerable fears have emerged concerning the dangers that such unchecked investor-state arbitration might entail for our own policy space. George Monbiot has polemicized in *The Guardian* that TTIP, with its investor-state dispute settlement (ISDS) provisions, would be a "full-frontal assault on democracy," pointing to the tobacco company Philip Morris' claim for billions against Australia after its Parliament passed plain packaging legislation on tobacco products, and to Eli Lilly's half-a-billion dollar claim against Canada after Canadian federal courts invalidated some of the US company's pharmaceutical's patents.⁴ International law luminary Martti Koskenniemi has warned that the ISDS provisions in TTIP would be "a transfer of power from public authorities to an arbitration body, where a handful of people would be able to rule whether a country can enact a law or not and how the law must be interpreted."⁵ Koskenniemi points not only to Philip Morris' claim, but also to the multi-billion claim by the Swedish energy company Vattenfall against Germany for its accelerated phasing out of nuclear power after Fukushima, based on the Energy Charter Treaty (which was hardly designed for investment in the EU Internal Market). More recently, the French Minister of Foreign Trade has expressed France's opposition to the inclusion of ISDS in TTIP, echoing fears that US investors could challenge French anti-fracking laws.⁶ A rather clear "Nein" also has come from the German Minister of Economy, reiterated recently also for CETA.⁷ In a debate in the UK House of Commons, a backbencher for the Conservative Party, Zac Goldsmith, asked his government: "Why do we need these tribunals for a country where the rule of law is adhered to, more or less across the board?" The UK House of Lords has most recently concluded that "proponents of investment protection provisions enforced by an ISDS mechanism have yet to make a compelling case for their inclusion in TTIP or to convincingly dispel public concerns".⁸ And ISDS has caused much turmoil in the confirmation of the new EU Commission.⁹

Many of these concerns may, in part, be less objective than one would like the political debate to be. But they do carry some weight, not only because the reasons given by the European Commission so far for including ISDS are weak and almost self-defeating, as I have tried to show in a separate policy paper.¹⁰ What is more, as rightly pointed out by the UK House of Lords, "ISDS provisions are in themselves only an enforcement mechanism: the substantive protections afforded to foreign investors in the investment chapter of a TTIP agreement would matter most." This was also my point in a report written for the European Parliament in December 2012, recently published with modifications in the

International and Comparative Law Quarterly.¹¹ There I tried to show how future EU investment agreements would, if framed along the lines of existing BITs and without proper safeguards, fundamentally change the current law of the Union as regards state liability, especially for legislative acts. Foreign investors in the EU would be able to obtain monetary compensation for legislative policy decisions that might be perfectly legal under EU law but are nevertheless found by an arbitral tribunal to be non-compliant with the standards of an EU investment agreement. This is true despite the fact that the Court of Justice of the EU, on the basis of the principles common to most EU member states, has limited the Union's liability for damages to private parties precisely with the aim of shielding the democratic policy making process from the risk of "regulatory chill".¹²

My report sparked a debate in the EU Parliament that had not been foreseen by the European Commission, which only wanted to pass a rather technical regulation for managing financial responsibility under future EU investment agreements. The European Parliament then voted virtually by unanimity (excepting only those parties which reject the EU altogether) for the inclusion of a crucial recital, which ultimately survived the opposition from both the Commission and the member states: "Union agreements should afford foreign investors the same high level of protection as Union law and the general principles common to the laws of the Member States grant to investors from within the Union, but not a higher level of protection. Union agreements should ensure that the Union's legislative powers and right to regulate are respected and safeguarded."¹³

As highlighted in my report, this was one possible reaction to the fears that investor-state arbitration tribunals would interpret substantive protection standards expansively and beyond the level of protection that EU investors are guaranteed in the EU, whose Internal Market is, after all, the world's most advanced economic integration project. A much more sophisticated solution would have been to do what Article 340(2) of the Treaty on the Functioning of the European Union suggests, and arguably even mandates: to work out in detail, on the basis of comparative studies, the principles of state liability common to the laws of the EU member states, including the rich national case law in this respect. This would lay a foundation for negotiations with third countries—rather than outdated and one-sided treaties merely patched to contain safeguards for EU policy space. Moreover, such a thorough approach would primarily achieve what investment treaty law should be all about and what existing investment treaties hardly deliver, namely, legal certainty for both the investors and the host states. Understandably, this much more cumbersome and time-consuming (academic) solution was much less attractive in political terms than a simple "no greater rights" affirmation.

While simple political solutions may address pressing public concerns, they sometimes risk turning *ad absurdum*. This would seem to be the case here: in line with the bipartisan negotiation principles first laid down in the 2002 US Trade Act, the former US Trade Representative Demetrios Marantis informed US Congress in March 2013 (six days before the "no

greater rights" principle was first adopted in the EU Parliament's Committee on International Trade) that the US government's specific objectives for the negotiations of the TTIP included to "seek to secure for US investors in the EU important rights comparable to those that would be available under US legal principles and practice, while ensuring that EU investors in the United States are not accorded greater substantive rights with respect to investment protections than US investors in the United States."¹⁴ "No greater rights" on both sides of the Atlantic...? If taken seriously, that is a riddle which only comparative public law studies on the principles of investment protection common to the US and the EU would really be able to solve.

Author

Jan Kleinheisterkamp is an associate professor of Law at The London School of Economics and Political Science.

Notes

- 1 European Commission. (2013, June 17). *Statement by President Barroso on the EU-US trade agreement with U.S. President Barack Obama, the President of the European Council Herman Van Rompuy and UK Prime Minister David Cameron*. Retrieved from http://europa.eu/rapid/press-release_SPEECH-13-544_en.htm
- 2 United States-European Union High Level Working Group on Jobs and Growth. (2013, February 2013). *Final Report*. Retrieved from http://trade.ec.europa.eu/doclib/docs/2013/february/tradoc_150519.pdf
- 3 Mann, F.A. (1981). British Treaties for the Promotion and Protection of Investments. *British Yearbook of International Law* 1981, 241.
- 4 Monbiot, G. (2013, November 4). This transatlantic trade deal is a full-frontal assault on democracy. *The Guardian*. Retrieved from <http://www.theguardian.com/commentisfree/2013/nov/04/us-trade-deal-full-frontal-assault-on-democracy>
- 5 Kontinen, J. Professor: Finland's legislative power may be in jeopardy. (2013, December 15). *Helsinki Times*. Retrieved from <http://www.helsinkitimes.fi/finland/finland-news/domestic/8717-professor-finland-s-legislative-power-may-be-in-jeopardy.html>
- 6 Hialut, R. (2014, October 3). Commerce : l'Europe et les Etats-Unis à couteaux tirés. *Les Echos*. Retrieved from http://www.lesechos.fr/10/03/2014/LesEchos/21643-029-ECH_commerce--l-europe-et-les-etats-unis-a-couteaux-tires.htm#L1c3Eo0lFOsyIqVZ.99
- 7 Donnan, Shawn., Wagstyl, S. (2014, March, 14). Transatlantic trade talks hit German snag. *Financial Times*. Retrieved from <http://www.ft.com/intl/cms/s/0/cc5c4860-ab9d-11e3-90af-00144feab7de.html#axzz3FNC8KkUy>
- 8 House of Lords, European Union Committee. (May 2014). *The Transatlantic Trade and Investment Partnership*. Retrieved from: <http://www.publications.parliament.uk/pa/ld201314/ldselect/lddeucom/179/179.pdf>
- 9 Spiegel, P. (2014, September 30). Malmström vs Selmayr: the tale of the track changes. *Financial Times – Brussels Blog*. Retrieved from: <http://blogs.ft.com/brusselsblog/2014/09/30/malmstrom-vs-selmayr-the-tale-of-the-track-changes/>
- 10 Kleinheisterkamp, J. (February 2014). *Is there a Need for Investor-State Arbitration in the Transatlantic Trade and Investment Partnership (TTIP)?* Retrieved from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2410188
- 11 Kleinheisterkamp, J. (2014). Financial Responsibility in European International Investment Policy. *International and Comparative Law Quarterly*, 63(2), 449-476. DOI: 10.1017/S0020589314000116
- 12 CJEU, joined cases C-120/06 P and C-121/06 P, *FIAMM v Council*, [2008] ECR I-6513, para. 174. <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62006CJ0120>
- 13 Recital 4 of Regulation (EU) No. 912/2014 of 23 July 2014 establishing a framework for managing financial responsibility linked to investor-to-state dispute settlement tribunals established by international agreements to which the European Union is party, [2014] OJ L 257, p. 121. <http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1413231149553&uri=CELEX:32014R0912>
- 14 Marantis, D. (2013, March 20). *Letter to John Boehner*. Retrieved from <http://www.ustr.gov/sites/default/files/03202013%20TTIP%20Notification%20Letter.PDF>

China's New Outward Investment Measures: Going Global in a Sustainable Way?

Joe Zhang

feature 4

Until recently, businesses in China seeking to make investments abroad had to go through a rigorous approval process separately conducted by two ministry-level agencies or their provincial counterparts. However, for many Chinese investors, especially those in the private sector, this unpopular approval process is becoming history as China's outward investment regime has undergone a drastic overhaul over the past year.

The previous approval process

Under the previous regime, one approval process was by conducted by the National Development and Reform Commission (NDRC), which sits under the State Council and has broad jurisdiction over fixed-asset investments. The NDRC approvals applied to all outward investment projects. For those projects involving cross-border biddings or mergers and acquisitions with a transaction amount over US\$100 million, prospective investors also had to obtain a confirmation letter, in essence another form of approval, from the agency prior to entering into any binding agreements or making binding offers.

The other approval process was managed by the Ministry of Commerce (MOFCOM), whose jurisdiction covers all cross-border enterprise-formation matters. While the NDRC approvals were project-based, the MOFCOM approvals were entity-based. Each prospective investor had to obtain approvals from MOFCOM for all of the overseas entities to be owned or controlled by such investors, irrespective of whether any specific project would be carried out through such overseas entity.

The new streamlined system

On December 2, 2013, the State Council issued a Catalogue of Investment Projects Subject to Government Approval (the Catalogue). In line with the current administration's pledge to simplify governance and decentralize power, as well as with China's "Going Global Strategy"—aiming at encouraging Chinese enterprises to invest overseas—the Catalogue indicates that only those projects with transactions amounting to US\$1 billion or more, as well as those projects involving sensitive countries, regions or industries would need to obtain prior approval from NDRC.¹ Similarly, MOFCOM's approval authority was limited to those investors making investments in sensitive countries, regions or in sensitive industries.² However, the Catalogue did not provide detailed guidance with respect to the new approval process, nor did it offer any definitions or examples for what would constitute "sensitive countries (regions)" or "sensitive industries." Further, the Catalogue did not address whether investments not subject to approval would be subject to any form of regulation, and if so, how.

Some additional clarity on those questions arrived on April 8, 2014, with the issuance of the NDRC's

Administrative Measures for Approving and Filling of Overseas Investment (which came into effect a month later). The NDRC Measures largely followed the prescription of the Catalogue and provided that only those projects identified in the Catalogue would be subject to NDRC approval,³ while others would only need to go through a relatively straightforward online filing procedure. In addition, the NDRC Measures also provided explanations on the two key terms not defined in the Catalogue. According to the NDRC Measures, "sensitive countries (regions)" are those "with no diplomatic relationships with China, subject to international sanctions or undergoing war or riot"⁴; and "sensitive industries" referred to in the NDRC Measures "include but not limited to basic telecommunication operation, cross-border water resource development and utilization, large-scale land development⁵, line power, electrical grids, and news media."⁶

MOFCOM also relaxed its approval requirements in its Administrative Measures for Overseas Investment issued on September 6, 2014 (and which went into effect on October 6, 2015), replacing an earlier version issued five years ago. Like its NDRC counterpart, the MOFCOM Measures also established that the filing system would become the norm and the approval requirements would be the exceptions, applying only to those investors identified in the Catalogue.⁷ However, when it comes to the key definitions, the MOFCOM Measures took a less precise approach. It defined "sensitive countries (regions)" as those "with no diplomatic relationships with China, subject to United Nations sanctions or other countries (regions) designated by MOFCOM when necessary"⁸; and "sensitive industries" as "industries involving products or technologies the exportation of which is restricted by China, or where more than one country (region) has an interest."⁹ The latter is particularly vague. Although a list of products and technologies restricted for export can be easily revealed by conducting a quick desk research on relevant catalogues published by the Chinese government, the reference to "involving" adds a significant dose of uncertainty to the scope of restricted projects. Would it be unreasonable, for instance, to infer that it covers manufacturing equipment to produce such restricted products or using the restricted products or technology in the development of downstream products or technologies? Leaving this text open for broad interpretation makes the legislation less predictable. In addition, the term "more than one country (region) has an interest" can be construed broadly. For example, the earlier version of the regulation also referred to a similar term without further explanation, and the MOFCOM and its provincial counterparts had construed it in practice covering not only any investments involving countries or regions where the sovereignty or territory were in disputes, but also any investments located in one country or region with

impact of operations reaching another country or region.

What impact on investment for sustainable development?

Although the new measures are yet to be fully tested in practice, the shift from the previous approval-based system to the new filing-based system has been largely welcomed by the enterprises in China that are contemplating going abroad. Despite the vague definitions noted above, the new system is undoubtedly a significant step towards a more streamlined process. Provided that other conditions remain favorable, it is reasonable to assume that it will therefore encourage more outward Chinese investment.

But aside from the *quantity* of investment, a key issue for host states will be the *quality* of that investment. For example, will the simplified pre-investment process open the floodgate for investors that had not been able to expand overseas (whether because they were unwilling or unable to pass the approvals under the previous system), or will the new measures free up the government resources from reviewing mountainous applications so that it can actually focus more on monitoring and regulating investment activities in host states? The government's intention seems to be the latter.

The MOFCOM Measures specifically requires that all Chinese investors observe the laws and local customs of the host states and pay attention to the performance of social responsibilities in areas including environment, employment and local communities;¹⁰ a requirement that did not exist in the previous legislation. To provide that requirement with necessary teeth, the MOFCOM Measures also grants MOFCOM and its provincial counter-parts the authority to supervise and monitor the performance of those obligations by Chinese investors overseas.¹¹

Although similar requirements are not spelled out in the NDRC Measures, according to relevant persons in charge of NDRC at a press conference introducing the new measures, one of the criteria the agency would look at when reviewing those projects subject to approval would be whether it was in compliance with the principle of mutual benefit and common development from the community and public interest perspective.¹² Indeed, according to an application template for projects subject to approval published by NDRC in May 2014, among the information required to disclose by applicants are information on project-related laws of host state, opinions from local communities, environmental measures taken by the applicant, etc.¹³

Furthermore, NDRC has also publicly pledged to prioritize regulating the investment activities and operations of overseas Chinese businesses by working closely with other agencies including

MOFCOM¹⁴, who also made a similar pledge when it issued the MOFCOM Measures in September.¹⁵

However, so far we have only seen a seemingly more streamlined pre-investment process for Chinese overseas investments. It will be interesting to watch the post-investment supervision and monitoring mechanism actually taking up its role as envisaged under the new regime.

Author

Joe Zhang is a legal advisor in the IISD's investment for sustainable development program.

Notes

¹ Catalogue of Investment Projects Subject to Government Approval (2013 Version), Article 13.

² *Id.*

³ Administrative Measures for Approving and Filing of Overseas Investment Projects, Article 7. Nevertheless, according to Article 8, for each outward investment project involving cross-border biddings or mergers and acquisitions with transaction amount over USD\$300 million, prior to entering into any binding agreements or making any binding offers, its investor had to obtain a confirmation letter from NDRC.

⁴ *Id.*

⁵ This may include all large scale agricultural, mining and infrastructure projects as the Land Management Law of China defines land to include agricultural land and construction land, the latter is further defined to include land used for mining and infrastructure.

⁶ Administrative Measures for Approving and Filing of Overseas Investment Projects, Article 7.

⁷ Administrative Measures for Overseas Investment, Article 6.

⁸ *Id.* Article 7.

⁹ *Id.*

¹⁰ *Id.* Article 20.

¹¹ *Id.* Article 5.

¹² Chinese summary of the press conference available at NDRC's website: http://www.sdpc.gov.cn/xwzx/xwfb/201404/t20140410_606609.html, last accessed 07 October 2014.

¹³ NDRC Notice Regarding Matters Relating to the Implementation of the Administrative Measures for Approving and Filing of Overseas Investment Projects, Appendix 2.

¹⁴ See *supra* note 11.

¹⁵ See summary of MOFCOM's press conference introducing the MOFCOM Measures, Chinese texts available at MOFCOM's website: <http://www.mofcom.gov.cn/article/ae/ag/201409/20140900724799.shtml>, last accessed 07 October 2014.

UNCTAD Multi-Stakeholder Meeting Seeks Reform of Investment Treaties and Investment Dispute Settlement

James Zhan and Diana Rosert

feature 5

More than 50 high-level representatives from governments, including ministers, as well as senior business representatives, international and civil society organizations convened in Geneva, Switzerland on October 16, 2014, to address the challenges arising from international investment agreements (IIAs) and to consider ways to reform the IIA regime.¹ The conference was held during the United Nations Conference on Trade and Development's (UNCTAD) World Investment Forum 2014, which attracted over 3000 participants from 150 countries. The IIA conference took place against the backdrop of growing dissatisfaction with the complex system of over 3,000 IIAs and, more specifically, the public debate surrounding so-called mega-regional agreements such as the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership.

Broad agreement on the need for reform

The conference was guided by three main questions: What are the key areas and pressing issues in IIAs and investment dispute settlement that need to be addressed? What are the key ways and means to address these issues? What types of mechanisms and platforms are needed to facilitate the reform?

The conference brought together a broad range of stakeholders and gave a voice to different interests within the investment and development community, helping to bridge divides between supporters and critics of the IIA regime. There was broad agreement on the need to improve global investment governance; however, many participants also emphasized that IIAs remain an important policy tool to help foster a stable and predictable business climate for the protection and attraction of FDI.

The view shared by many speakers was that the IIA regime and the related investment dispute settlement system required comprehensive reform, but that these changes should be introduced gradually. Starting from a number of pressing reform issues, the meeting identified concrete and workable solutions to address them. In so doing, the conference participants sketched out the contours of a roadmap for comprehensive reform of the IIA regime, and called upon UNCTAD to further refine the elements of the map together with governments, regional and inter-governmental organizations and other stakeholders.

Why a roadmap is needed was described, amongst others, by the Vice Chairman of the Egyptian General Authority for Investment, Ms. Wafaa Sobhy Ibrahim. She said "most countries acknowledge that their investment policies are in need of reform to alleviate concerns related to investment dispute settlement and public policymaking. What we miss is a framework to implement their efforts." In this context, it was said that UNCTAD's Investment Policy Framework for Sustainable

Development² and the reform paths identified by UNCTAD³ could serve as valuable starting points.

Many countries considered individual reform efforts to be useful, but also noted that these may not be sufficient in light of the need to address systemic challenges. Some country representatives emphasized that joint, coordinated or multilateral efforts can be more effective in bringing about needed reforms. It was suggested that UNCTAD, in cooperation with other stakeholders, including international and regional organizations, could provide a multilateral platform for engagement on investment policy issues. Ms. Yongjie Li, Director at the Ministry of Commerce of the People's Republic of China, said that reforming treaties at the country level "cannot address all the challenges posed by its existing treaties" and that "potential systematic reform is more suitable to be discussed at the appropriate multilateral platform."

Pressing reform issues—core treaty provisions and investment arbitration

Many participants emphasized that IIAs must not limit countries' capacity to regulate investment for legitimate national development objectives. Indeed, there was broad consensus on the need for a more coherent and well-designed IIA regime that reflects sustainable development objectives, balances investors' rights and obligations, corresponds to modern economic realities (such as the proliferation of global value chains) and offers a higher degree of predictability. In particular, provisions on definitions of investment and investor, fair and equitable treatment, most favoured nation treatment, indirect expropriation or the umbrella clause were mentioned as needing careful consideration.

With respect to investment dispute settlement, stakeholders' suggestions for reform addressed, among others, transparency, frivolous claims, speculative investors, independence of arbitrators, and an appeals mechanism. There were also calls to omit investor-state dispute settlement from investment treaties altogether. Consideration was also given to alternatives to investor-state arbitration, and some participants stressed the importance of alternative dispute resolution, as well as requiring investors to exhaust local remedies as a pre-condition to accessing arbitration. The need to refine substantive legal obligations applied by tribunals was identified as a key, complementary area of reform. Several country delegates called for more technical assistance and capacity building in this regard.

The conference benefitted from the experience of Argentina, Canada, the Czech Republic, Egypt, Ecuador and Mexico, which are among the most frequent defendants in investor-state arbitrations. Mr. Germán A. Herrera Bartis, Director at Argentina's Ministry of Foreign Affairs and Worship, highlighted the need for reform by referring to the "ambiguity of the concept of indirect

expropriation,” through which “[v]irtually any changes in economic policies [...] may be considered expropriation by a foreign investor and the subject of litigation in the field of ICSID.”

Concrete examples of IIA reform and alternative approaches

The participants also discussed the concrete steps countries can take when reforming their investment treaties, with some countries sharing their experiences in this respect. Mr. Saurabh Garg, Joint Secretary (Investment), Department of Economic Affairs, Ministry of Finance, India, put forward the view that “any new treaty must be subject to rigorous review, with a careful analysis of clauses such as definition of investment and investor, FET and MFN.”

At the same time, new approaches to international investment policy making were also discussed. Mr. Daniel Godinho, Secretary of Foreign Trade at Ministry of Development, Industry and Foreign Trade of Brazil, a country that has signed some BITs in the past but did not ratify them, drew attention to Brazil’s completion of a new model investment agreement as an “innovative alternative to traditional IIAs.” Brazil’s model, which it calls a Cooperation and Facilitation Investment Agreement, focusses on “the promotion of an attractive environment for investors while preserving space for public policies.” The model foresees the creation of focal points (ombudsmen, designed to serve as an important communication and support channels between investors and the host country and to improve investment conditions in the latter) and a joint committee composed of government representatives of both parties, which would be responsible for sharing opportunities for the expansion of mutual investment, monitoring the implementation of the Agreement, preventing disputes and solving possible disagreements in an amicable manner. Similarly, participants stressed the role of domestic laws and contracts for creating a favourable investment climate and attracting investment that promotes sustainable development.

Reform efforts in light of the continued relevance of IIAs

The countries represented at the conference included those that have been most active in signing IIAs, such as China, Egypt, France, Germany, Switzerland and the United States; each of these countries have concluded more than 100 bilateral investment treaties. Mr. Christian Etter, Head of Switzerland’s State Secretariat for Economic Affairs, Switzerland, stated that, in Switzerland’s view, that IIAs are a tool to attract FDI and “a proven instrument to promote sustainable development.” He added that “as with any instrument, they [IIAs] need continued examination and adjustment when required by circumstances.”

Private sector representatives emphasised the importance of high levels of investor protection in the

current IIA regime, while recognizing the need for reform at the same time. In the opinion of Mr. Winand Quaedvlieg, Chair of the Investment Committee of the Business and Industry Advisory Committee to the OECD, “investment protection is an indispensable element of any investment regime [...] and ISDS in its turn is a necessary element of investment protection. [...] But a number of issues merit further examination, without at this stage prejudicing the outcome.”

Some speakers stressed that rather than leading to reduced levels of investor protection, reforms should lead to more balanced treaties that offer legal precision to the benefit of states and investors alike, while preserving policy space and reflecting investor responsibilities. “The future of the IIA regime is also important for the private sector: IIAs needs to function better for governments and investors alike,” stated Ms. Stormy-Annika Mildner from the Federation of German Industries.

Next steps

As a follow-up to the WIF IIA Conference, UNCTAD will convene an intergovernmental experts meeting from February 25-27, 2015, in Geneva, where experts will identify concrete strategies and measures that would contribute to the creation of a new generation of IIAs. Another IIA conference will be held at the next World Investment Forum in March 2016 in Lima, Peru, building on the success of this year’s Forum.

Author

James Zhan is Director of UNCTAD’s Division on Investment and Enterprise and Chief Editor of the World Investment Report. Diana Rosert, is Associate Legal Affairs Officer, in UNCTAD’s Section on International Investment Agreements.

Notes

1 The list of speakers and their statements are available at <http://unctad-worldinvestmentforum.org/programme/sessions/reforming-the-international-investment-agreements-regime/>

2 Available at http://unctad.org/en/PublicationsLibrary/diaepcb2012d5_en.pdf

3 Available at http://unctad.org/en/PublicationsLibrary/webdiaepcb2014d6_en.pdf

news in brief

New European Commissioners suggest that ISDS may be shut out of the TTIP

The new President of the European Commission, Jean-Claude Juncker, said on October 22, 2014 that there is “no obligation” to include investor-state dispute settlement (ISDS) provisions in the trade and investment agreement under negotiation between the European Union and the United States, the Transatlantic Trade and Investment Partnership (TTIP).

Resistance to the dispute settlement mechanism, which has been a common feature in the bilateral investment treaties signed by EU member states in the past, has grown significantly in the EU as governments and civil society question its utility in the TTIP (and in a trade agreement with Canada, as discussed below).

In recognition of that pushback, Juncker said his “commission will not accept that the jurisdiction of courts in the EU member states be limited by special regimes for investor-to-state disputes. The rule of law and the principle of equality before the law must also apply in this context.”

Juncker’s statement does not rule out the inclusion of ISDS in the EU-US trade and investment deal, but it opens the door to doing so.

The new Trade Commissioner, Cecilia Malmström, has also taken a negative posture towards ISDS. Just before her confirmation hearing, her written comments to the European Parliament on September 26 stated that “no investor-state dispute settlement mechanism will be part of that agreement [TTIP].”

In response to many who celebrated her declaration on social media, Malmström later tweeted that “the sentence everybody is so excited about on ISDS/TTIP is not written by me in the final version of my answer to the EP.” The version of her reply resubmitted to the Parliament on September 28 (past the September 26 deadline) did not include the sentence rejecting ISDS.

Earlier this year the European Commission held public consultations on ISDS in the TTIP; 150,000 responses were submitted by the extended 13 July 2014 deadline, and results are scheduled for publication and discussion in November 2014.

Many of the replies were identical, motivated by Europe-wide campaigns against ISDS that provided ready-made replies. In a meeting of the EU Committee on International Trade on July 22, the Trade Commissioner at the time, Karel De Gucht, expressed his understanding that from a political viewpoint it would make sense to analyze the answers both quantitatively and qualitatively, taking “all the identical ones for one.” However, members of the European

Parliament and CSOs argue that this would downplay critical public sentiment regarding ISDS.

Some EU governments oppose ISDS in CETA, despite recently concluded negotiations

Meanwhile, there is ongoing opposition to inclusion of ISDS in the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union. The text of that agreement was finalized in August 2014 following 5 years of negotiation. Canadian and EU dignitaries pledged their political commitment to CETA on September 26, without formally signing it.

However, opposition to the text by EU member states—again, to ISDS in particular—and other stakeholders may put CETA at risk. Critics say ISDS is unnecessary in view of existing protections of investors under domestic legal systems.

Germany’s Minister of Economy, Sigmar Gabriel, stated on September 25 that “Germany and Canada’s legal systems offer sufficient protection for corporations, making such a clause superfluous.” France’s former Minister of Trade, Nicole Bricq, has also publicly opposed ISDS. However, the former EU Trade Commissioner Karel De Gucht said reopening CETA for renegotiation would kill the agreement.

Civil society organizations in Canada and the European Union have also protested the closed-door nature of the CETA negotiations, the excessive powers it gives to investors, the further liberalization of services, the limitation of the right to regulate, the lowering of consumer standards, among other perceived problems.

Officially published on September 26, CETA will be submitted to the EU Council and to the European and Canadian Parliaments for ratification. It has been reported that the European Parliament will not be able to analyze the text before late 2015. If, against the European Commission’s wishes, it is ultimately considered that CETA is a mixed agreement, requiring ratification by the parliaments of all 28 member states, it might enter into force as late as 2017.

CETA is seen as a template for the more far-reaching Transatlantic Trade and Investment Partnership between the European Union and the United States.

awards & decisions

Yukos shareholders awarded record damages in two separate proceedings against Russia

Martin Dietrich Brauch

In two separate proceedings, shareholders of the defunct Russian oil and gas company OAO Neftyanaya Kompaniya Yukos (Yukos) were awarded over US\$52 billion in compensation from Russia for expropriation and due process of law violations.

On July 18, 2014, an UNCITRAL tribunal under the Permanent Court of Arbitration (PCA) ordered Russia to pay over US\$50 billion in compensation for expropriation in breach of the Energy Charter Treaty (ECT). Two weeks later, on July 31, 2014, the European Court of Human Rights (ECtHR) published a majority judgment ordering Russia to pay over €1.86 billion in damages for breaches of the European Convention for the Protection of Human Rights and Fundamental Freedoms (Convention) and Protocol No. 1 to the Convention (Protocol).

Although the damages sought were much higher (2.36 times more in the PCA arbitrations, and 20 times more in the ECtHR case), the amounts awarded are the largest yet seen in investment treaty arbitration and in an ECtHR judgment, respectively. The direct beneficiaries of the PCA award are three companies that jointly held 70.5 percent of Yukos. The ECtHR judgment will benefit all shareholders of Yukos at the time of liquidation.

Yukos was created as a joint stock company in 1993 and privatized in 1995, with operations across the oil and gas sector; Yuganskneftegaz (YNG) was its main production subsidiary. In 2002, Yukos was Russia's largest company in the sector and listed as one of the world's top ten oil and gas companies by market capitalization. After a series of measures by Russia starting in July 2003, including tax reassessment and enforcement proceedings, Yukos was declared bankrupt in August 2006. Yukos was struck off the registry of companies in November 2007 and its assets nationalized. Russian state-owned companies Gazprom and Rosneft acquired Yukos' remaining assets.

What follows are summaries of the judgements in both sets of proceedings.

The PCA tribunal awards

Hulley Enterprises Limited (Cyprus) v. The Russian Federation (PCA Case No. AA 226)

Yukos Universal Limited (Isle of Man) v. The Russian Federation (PCA Case No. AA 227)

Veteran Petroleum Limited (Cyprus) v. The Russian Federation (PCA Case No. AA 228)

Factual background and claims

Among Russia's measures alleged to have breached the ECT are the criminal prosecution of the company and its management; Mikhail Khodorkovsky (CEO of Yukos and supporter of Russian opposition parties), Platon Lebedev (Director of two of the claimant companies) and Vasily Shakhovskiy (President of Yukos-Moscow) were charged and convicted of crimes including embezzlement, fraud, forgery and tax evasion. To escape similar charges, other executives fled Russia, such as Leonid Nevzlin (Deputy Chairman of the Yukos Board of Directors). During the arbitrations, Russia referred to Khodorkovsky, Lebedev, Nevzlin and others as the "oligarchs"—the individual owners of the claimant companies—and emphasized that they were involved in illegal activities. Russia characterized Yukos as a "criminal enterprise" that perpetrated embezzlement, tax evasion through the misuse of special low-tax zones, tax fraud and schemes to avoid the enforcement of tax liens, as well as transfer pricing schemes to divert the proceeds from the sale of oil to offshore shell companies owned by the "oligarchs."

According to the claimants, Russia also imposed tax reassessments, VAT charges, fines and asset freezes against Yukos; threatened to revoke its licenses; annulled its merger with Russian oil company Sibneft; and forced it to sell YNG. They argued that, along with the harassment of Yukos' executives, these measures amounted to a breach of the fair and equitable treatment (FET) standard under the ECT Article 10(1) and to an indirect expropriation in violation of ECT Article 13(1).

The interim award on jurisdiction

On November 30, 2009, the tribunal upheld its jurisdiction in an interim award, deciding the following issues.

Provisional application. ECT Article 45(1) mandates signatories to provisionally apply the treaty pending ratification. Russia signed the ECT on December 17, 1994, but never ratified it. On August 20, 2009, during the proceedings, Russia notified the depositary of its intention not to ratify the treaty. The tribunal held that the ECT provisionally applied to Russia from the date of its signature until October 18, 2009 (60 days after the notification). It also held that investments made in Russia during provisional application would benefit from the ECT's protections for 20 years, that is, until October 19, 2029. Therefore, Russia's notification had no effect on jurisdiction.

Russia argued that it could only apply provisionally those treaty provisions that were consistent with Russian law, and that the dispute settlement provisions were not. The tribunal, however, held that

“either the entire Treaty is applied provisionally, or it is not applied provisionally at all” (para. 311). In addition, it concluded that provisional application depended on whether the principle of provisional application itself was consistent with the state’s domestic law. The tribunal found that to be the case under Russian law.

Claimants as “investors.” Russia argued that the claimants, as companies owned and controlled by Russians, did not qualify as “investors.” Referring to ECT case *Plama v. Bulgaria*, the tribunal held that, as the claimants were organized under the laws of Cyprus, a Contracting Party to the ECT, they were protected investors, irrespective of the nationality of their owners or controllers.

Denial of benefits. Under ECT Article 17(1), a state may deny substantive treaty protections to an entity that has no substantial business where it is organized. Russia argued that it exercised this right by means of its 1994 Agreement with the European Union on Partnership and Cooperation, which determines that companies with a registered office in a state may only be considered companies of that state if they possess real and continuous links with its economy. The held that, as the 1994 Agreement and the ECT did not refer to each other, Russia had not exercised its right.

Fork-in-the-road. ECT Article 26(3)(b)(i) contains a fork-in-the-road provision: states listed in Annex ID (including Russia) do not grant consent to arbitration if the investor previously submitted the dispute to other means of resolution. Russia objected to jurisdiction, pointing to the other proceedings initiated by the “oligarchs” in Russian courts and their applications to the ECtHR. However, the tribunal concluded that Russia’s objection did not pass the “triple identity” test: “identity of parties, cause of action and object of the dispute” (para. 592).

Jurisdictional objections in the final award

The tribunal had postponed two jurisdictional issues to the merits phase: (a) whether the claimants’ wrongdoings deprived them of ECT protection (the “unclean hands” objection); and (b) whether the tribunal had jurisdiction over claims with respect to “Taxation Measures” other than those based on expropriatory “taxes” (the Article 21 objection).

Unclean hands objection

Listing 28 instances of alleged “illegal and bad faith conduct” by the claimants, Russia argued that the claimants ran a “criminal enterprise,” leading to lack of jurisdiction, inadmissibility of claims, or deprivation of the substantive protections of the ECT.

According to the claimants, their alleged misconduct could not impact the arbitrations for three reasons: the

“unclean hands” principle is not in the ECT; neither is it a general principle of law; and their misconduct would amount to mere “collateral illegalities.” Those reasons guided the tribunal’s analysis.

Invoking ECT case *Plama v. Bulgaria*, the tribunal supported the view that the substantive provisions of the treaty did not apply to investments made illegally, even in the absence of language to that effect. As the treaty seeks to encourage legal investments made in good faith, investments made otherwise should not benefit from it.

Russia argued that not only illegalities in the *making* of the investment, but also in its *performance*, barred ECT claims. However, the tribunal was not persuaded, as denying the claimants’ right to initiate arbitration would undermine the ECT’s object and purpose.

Neither was it persuaded that the “clean hands” doctrine constituted a general principle of law, agreeing with the claimants that Russia failed to cite a majority decision in which the principle was applied and operated to bar a claim.

The tribunal considered that only illegalities related to the *making* of the investment, but not those carried out in its *performance*, could bar ECT claims. Analyzing the alleged illegalities in the acquisition of Yukos, the tribunal indicated that they were taken not by the claimants themselves, but by the “oligarchs” and other actors, before the claimants became shareholders of Yukos, and were not sufficiently connected with the transactions that consolidated claimants’ investment. While rejecting the jurisdictional objection, the tribunal recognized that the alleged illegalities could impact liability and damages.

Article 21 objection

Russia submitted that, under ECT Article 21, “taxation measures” broadly were “carved out” of the tribunal’s jurisdiction, while the same article provided for a narrow “claw-back” with respect to expropriatory “taxes,” but not other expropriatory “taxation measures.” Accordingly, Russia argued that the tribunal only had jurisdiction over claims concerning expropriatory taxes. Since the measures complained of were not taxes, but, more broadly, taxation measures, the tribunal would be devoid of jurisdiction.

The tribunal disagreed that the carve-out was broad and that the claw-back was narrow: assuming the taxation measures carve-out applied, any exempt measures would nonetheless be covered by the expropriation claw-back.

Furthermore, the tribunal agreed with claimants that Russia’s actions consisted in measures “under the guise of taxation,” aimed at bankrupting Yukos, appropriating its assets and politically harming its

CEO. The tribunal referred to similar conclusions in *RosInvestCo v. Russia* and *Quasar v. Russia*, and held that the carve-out did not apply, thus upholding its jurisdiction.

Reasonable expectations and indirect expropriation

In the tribunal's view, the claimants should have expected that their tax avoidance operations could prompt adverse reactions from Russia, but not that they would be so extreme. The tribunal considered that Russia's measures had an effect equivalent to expropriation, and set out to analyze the elements of an illegal expropriation under ECT Article 10.

First, the tribunal found it questionable whether the expropriation of "Russia's leading oil company and largest taxpayer" was in the public interest, pointing out that it was in the interest of state-owned oil company Rosneft, which is not the same (para. 1581).

Second, it considered that the treatment of Yukos might have been discriminatory, but did not see a reason to delve into the matter.

Third, while Yukos was subjected to processes of law, the tribunal did not find that the expropriation was "carried out under due process of law," in view of the harsh treatment accorded to the executives and counsel of Yukos. The tribunal went so far as to state that the Russian courts, in sentencing Khodorkovsky and Lebedev, "bent to the will of Russian executive authorities to bankrupt Yukos, assign its assets to a State-controlled company, and incarcerate a man who gave signs of becoming a political competitor" (para. 1583).

Finally, given that Yukos was expropriated without compensation, Russia was found to be in breach of its obligations under ECT Article 13, and therefore liable under international law, without a need to consider whether it breached ECT Article 10 on fair and equitable treatment.

Contributory fault

The tribunal went on to determine whether and to what extent the compensation should be reduced because of the claimants' wrongdoing, based on the legal principle of contributory fault. It found that, among the claimants' many wrongdoings, only their abuse of low-tax regions and their misuse of the Cyprus-Russia tax treaty lessened Russia's responsibility, contributed to the prejudice they suffered, and should lead to a reduction in the damages.

Noting the difficulty in determining the extent and proportion of the fault of each party, the tribunal referred to two earlier cases: the annulment committee in *MTD v. Chile* and *Occidental v. Ecuador*. The *Occidental* tribunal (which, like the Yukos arbitrations,

was chaired by Yves Fortier) determined that the claimants' contributory fault led to a 25 percent reduction. The Yukos tribunal, "having considered and weighed all the arguments" and "in the exercise of its wide discretion," agreed that in this case a 25 percent reduction was a "fair and reasonable" apportionment of responsibility (para. 1637).

Interest

The claimants had proposed three interest rates, but the tribunal rejected all of them. It found that LIBOR had been "discredited," that the yield on Russian sovereign bonds would lead to "excessive compensation" (para. 1679), and that the U.S. prime rate was not appropriate as there was no evidence that the claimants had to borrow money because of the expropriation.

The tribunal looked for guidance in *Santa Elena v. Costa Rica* (chaired, as the Yukos tribunal, by Yves Fortier), which supported using a rate based on the amount of interest that would have been earned on compensation had it been paid right after the expropriation—the "investment alternatives approach." A rate based on ten-year U.S. Treasury bond rates was seen as appropriate by the tribunal, "in the exercise of its discretion" (para. 1685). While recognizing that compounded interest has become more frequent in investor-state arbitrations, it regarded as "just and reasonable" to grant simple pre-award interest and annually compounded post-award interest, if Russia does not fully pay the damages and costs within the 180-day grace period (para. 1689).

Quantification of damages

The claimants argued that the expropriation had occurred on November 21, 2007, when Yukos had ceased to legally exist, but the tribunal found that it had been crossed on December 19, 2004, the date of the forced auction of YNG. Finding support in *Kardassopoulos and Fuchs v. Georgia* and other decisions, the tribunal held that, having suffered an unlawful expropriation, the claimants could choose between valuations based on the expropriation date or on the award date.

As to causation, the tribunal considered that, but for the tax assessments and other enforcement measures, the claimants would not have suffered the damage. Russia suggested that the claimants could have mitigated their damages, but the tribunal concluded that, even if the claimants had paid the taxes and filed tax returns, Russia would have still taken the enforcement measures aimed at bankrupting Yukos.

According to the tribunal, the claimants were entitled to three heads of damages: the value of their shares,

the value of lost dividends, and pre-award simple interest on both.

The claimants advanced eight valuation methods, resulting in amounts between US\$74 billion and US\$129 billion. Ultimately, the tribunal adopted the figure that resulted from the 'comparable companies' method, with a few corrections by Russia, as a starting point.

Once again exercising its discretion, the tribunal fixed the amounts of dividends as rough averages between the figures presented by the claimants and by Russia. It arrived at round figures of dividends at US\$2.5 billion in 2004, and of US\$45 billion from 2004 through the first half of 2014.

Accordingly, the tribunal found total damages of US\$21.988 billion for the expropriation date, and of US\$66.694 billion for the award date (fixed as June 30, 2014). Considering the higher amount only, and reducing it by 25 percent to account for contributory fault, the tribunal fixed damages at US\$50,020,867,798, to be distributed among the claimants according to their participation in Yukos.

Costs

Arbitration costs and expenses amounted to €8,440,000. Russia, which had deposited €4,200,000 with the PCA for costs, was ordered to reimburse the €4,240,000 deposited by the claimants.

The claimants indicated that their legal costs amounted to US\$79,628,055.56 in the jurisdictional phase plus £1,066,462.10 in the merits phase. "In the exercise of its discretion," the tribunal thought it "fair and reasonable" for Russia to reimburse US\$60 million of the claimants' legal costs, noting that this amounted to approximately 75 percent of their schedule of costs (para. 1887).

The ECtHR's Just Satisfaction Judgment

Case of Oao Neftyanaya Kompaniya Yukos v. Russia (Application No. 14902/04)

Claims and the principal judgment

In its April 23, 2004 application, Yukos complained that Russia, by conducting expedited tax assessment proceedings, imposing disproportional penalties and enforcing them against the company in the early 2000s, breached Yukos' due process of law rights under the Convention and unlawfully deprived it of its possessions, in violation of the Protocol.

By its principal judgment of September 20, 2011, a majority court held that the tax assessments did not allow sufficient time for Yukos to prepare its case, in breach of the due process of law guarantees of

Convention Article 6. It also held that the imposition and calculation of tax penalties violated Protocol Article 1, which guarantees the right to peaceful enjoyment of property and protects against unlawful expropriation, while reserving the state's right to enforce its laws to control property and to secure payment of taxes and penalties. Furthermore, the court held that the enforcement proceedings breached the same article, in that they "failed to strike a fair balance between the legitimate aim of the proceedings and the measures employed" (holding, para. 7).

Convention Article 41 provides that, where the court finds a violation of the Convention or its protocols, it "shall, if necessary, afford just satisfaction to the injured party." Accordingly, Yukos sought €37,981,000,000 in pecuniary damages. In the principal judgment, the court held unanimously that the Article 41 question was not ready for decision, and postponed the issue—ultimately decided in the July 31, 2014 judgment.

Pecuniary damage

Based on its expert's assessment of the company value on December 19, 2004, Yukos estimated that it had suffered a direct loss of €37,981,000,000, without any claim for interest payments. Russia argued that Yukos was worthless because of fraudulent tax management and the resulting legal risks.

The court focused on three heads of damages, based on each of the violations found in its principal judgment: (i) the violation of Convention Article 6; (ii) the violation of Protocol Article 1 on account of the retroactive imposition of tax penalties for the years 2000 and 2001; and (iii) the violation of Protocol Article 1 on account of the unbalanced enforcement proceedings. The court then ruled on the method of distribution of the damages.

Violation of Convention Article 6

The court noted that the violation drew from the rushed manner with which Russian courts conducted the tax assessments. As the court could not speculate as to what would have been the results of those proceedings in the absence of the violation, it awarded no damages with respect to this head.

Violation of Protocol Article 1 on account of the retroactive imposition of tax penalties

The court recalled that, in its principal judgment, it had found a violation of Protocol Article 1 in the penalties resulting from the 2000 tax assessment and, in part, in the penalties resulting from the 2001 assessment. Given that Yukos paid those amounts during the enforcement proceedings, the court

reasoned that they represented a clear pecuniary loss subject to compensation under Convention Article 41 and in accordance with the principle of *restitutio in integrum*, established in the court's case law. It added that, since the original penalties were unlawful, so were the 7 per cent enforcement fees applied by Russia.

Therefore, the court started from the full amount of the penalties for the year 2000 and from one-half of the penalties for the year 2001. To each of the amounts, it added 7 per cent to account for the enforcement fees. It then converted the amounts from Rubles to Euros according to the conversion rate on their estimated payment date. Finally, it adjusted the amounts for the inflation rate of 12.62 per cent for the Euro between the date of payment and the date of the judgment. These calculations resulted in €1,299,324,198.

Violation of Protocol Article 1 on account of the unbalanced enforcement proceedings

Yukos had argued that the company would have survived the enforcement proceedings, which led to the forced sale of YNG, had they been conducted lawfully. Although it could not reach that conclusion, the court emphasized that the unlawful proceedings seriously contributed to the company's demise and resulted in pecuniary damage compensable under Convention Article 41.

The 7 percent enforcement fee for the years 2000 through 2003 resulted in an amount "completely out of proportion to the amount of the enforcement expenses which could have possibly been expected to be borne or had actually been borne" (principal judgment, para. 655). "Making a reasonable assessment of the enforcement fee and having regard to the parties' submissions," the court accepted the figure advanced by Russia, deciding that "in order to satisfy the requirements of proportionality the enforcement fee should have been reduced to 4%" (para. 32).

To avoid double compensation, the court took the entire amount of enforcement fees paid at 7 percent and deducted from it the amount paid on the unlawful portion of the penalties for the years 2000 and 2001. It further deducted the amount of the fees calculated at 4 per cent, the rate deemed reasonable by the court, thus reaching an inflation-adjusted amount of pecuniary loss of €566,780,436.

Method of distribution of the award

In view of the liquidation of Yukos, the claimant asked the court to determine that the total damages of €1,866,104,634 be paid to Yukos International Foundation (YIF), an entity established to pay Yukos' creditors and distribute funds to its shareholders. Russia argued that the court did not have

jurisdiction to delegate to YIF the power to grant just satisfaction. It indicated that the beneficiaries of YIF were anonymous, that there was risk of double compensation as some shareholders had initiated parallel proceedings, and that a distribution by YIF might not reflect the interest of all shareholders.

The court dismissed Yukos' suggestion, finding no evidence of who would benefit from the award were it paid to YIF. Considering that the Yukos company no longer existed, it ruled that Russia paid the damages to the "company's shareholders and their legal successors and heirs, as the case may be, in proportion to their nominal participation in the company's stock" at the time of the company's liquidation, according to the official records (para. 38).

Russia had pointed out that managers and shareholders who had instigated Yukos to commit tax fraud and benefited from it should not be compensated. The court did not see reason to reduce the award on that account, as Yukos had already been held liable for tax fraud.

Russia had also argued that no compensation should be paid resulting from the invalidation of the penalties, considering that at the time of liquidation Yukos still owed about US\$8 billion to Russia. The court noted that the Yukos' outstanding debt was at least in part attributable to the decision of Russian authorities, who preferred to push Yukos to sell assets, assuming the risk that it might be unable to pay all of its debt. Rejecting Russia's argument, the court noted that the 2007 enforcement and liquidation proceedings extinguished any debt that Yukos may have had.

In response to Russia's reference to parallel proceedings, the court recognized that investment tribunals had rendered two final awards, in 2010 and 2012, in cases brought by minority shareholders. Yet the court noted that the case file contained no information on the enforcement of those awards. The court also reasoned that Russia's reference to the PCA proceedings was irrelevant, as they were still pending.

Non-pecuniary damage

In line with Yukos' submission undisputed by Russia, the court held that the findings of Convention and Protocol violations constituted sufficient just satisfaction for non-pecuniary damage.

Costs and Interest

Yukos requested payment of roughly €6.1 million for costs and expenses. Considering the documents in the file and referring to its case law, the court held that it was reasonable to award Yukos a lump sum of €300,000. It also determined that the default interest rate would be the marginal lending rate of the European Central Bank plus 3 per cent.

Notes:

- The PCA tribunal was composed of Yves Fortier (chair), Charles Poncet (claimants' nominee) and Stephen Schwebel (respondent's nominee). The three final awards, as well as the three awards of November 30, 2009 on jurisdiction and admissibility, are available at http://www.pca-cpa.org/showpage.asp?pag_id=1599.
- For more information on the issues and legal reasoning behind the PCA awards, and the difficulties in their enforcement, see an earlier ITN summary available at: <http://www.iisd.org/itn/2014/09/04/yukos-v-russia-issues-and-legal-reasoning-behind-us50-billion-awards>.
- The ECtHR sat as a Chamber composed of Christos Rozakis (President); Dean Spielmann, Nina Vajtiš, Khanlar Hajiyev, Sverre Erik Jebens and Giorgio Malinverni (judges); and Andrey Bushev (ad hoc judge). The judgment on just satisfaction of July 31, 2014 is available at <http://hudoc.echr.coe.int/sites/eng/pages/search.aspx?i=001-145730>. The earlier, principal judgment of September 20, 2011 (rectified on January 17, 2012, final on March 8, 2012) is available at <http://hudoc.echr.coe.int/sites/eng/pages/search.aspx?i=001-106308>.

ICSID committee declines to annul award finding breaches of fair and equitable treatment obligation by Argentina

El Paso Energy International Company v. Republic of Argentina, ICSID Case No. ARB/03/15

Matthew Levine

An ICSID annulment committee declined the Argentine Republic's application to annul an approximately US\$43 million award in favor of an American company, El Paso Energy International Company. The annulment committee rejected Argentina's claim that the award relied unduly on the notion of creeping violations of the fair and equitable treatment (FET) standard in the Argentina–United States BIT.

Background

El Paso is a Houston-based energy company that had invested in a series of Argentine companies providing gas-related services. Following a financial crisis in Argentina, El Paso initiated investor-state arbitration in relation to, *inter alia*, the peso-isation (the forced conversion of dollars to pesos) of various contracts between its investments and branches of the state.

On October 21, 2011, an ICSID tribunal of Piero Bernardini, Brigitte Stern and Lucius Caflisch issued an award for \$43.03 million (plus compound interest)

in favour of El Paso. The award had notably found that the sum-total of Argentina's crisis response led to a "creeping" form of unfair treatment. This was despite the fact that the tribunal had rejected all of El Paso's specific claims for frustrated expectations.

On February 28, 2012, ICSID received Argentina's application for annulment. On May 22, 2012, an ad hoc committee of Teresa Cheng, Rolf Knieper, and Rodrigo Oreámuno was constituted

Creeping violation of the fair and equitable treatment standard

Argentina argued that the tribunal had created a new standard: "in the same way as one can speak of creeping expropriation, there can also be creeping violations of the FET standard."

Argentina further claimed that the tribunal resorted to Article 15 of the ILC's Draft Articles, which contains the concept of composite acts. Further, Argentina noted that the BIT "... does not contain a standard condemning the performance of a series of lawful acts or the commission of creeping violations of the fair and equitable treatment standard and the Tribunal lacks the legislative capacity to create it."

The committee reviewed Argentina's arguments in light of the three relevant grounds for annulment: a manifest excess of powers, a failure to state reasons, and a serious departure from a fundamental rule of procedure.

In terms of a manifest excess of powers, the committee found that "what the Tribunal did in the Award was an interpretation of fair and equitable treatment of the BIT in relation to the facts of the case, based on what was decided [in previous cases]." The committee further found that the mere fact of the concept of a creeping violation of fair and equitable treatment being mentioned was not the reason for the finding of liability.

With respect to a failure to state reasons, the committee acknowledged Argentina's allegation that creeping violation of fair and equitable treatment standard was a "judicial creation." However, the committee found that a "judicial creation" would if anything be the opposite of a failure to state reasons.

In terms of a serious departure from a fundamental rule of procedure, as a threshold matter of law the committee indicated support for the position taken by previous committees that the relevant breach must have had a material impact on the outcome of the award. Argentina argued that, by sanctioning a creeping violation of FET, the tribunal affected legal certainty thereby seriously departing from fundamental rules of procedure. This was dismissed on the ground that Argentina had not identified the

specific rule of procedure at issue.

Necessity analysis: the relationship between treaty and custom

Argentina also identified a variety of alleged shortcomings in the tribunal's treatment of necessity: the tribunal ignored Argentina's evidence on the self-judging nature of the relevant treaty provision; it failed to examine Argentina's customary international law defense; and, it failed to apply the provisions on non-discriminatory emergency loss measures in the BIT.

As regards Argentina's claim that the tribunal ignored its evidence regarding the self-judging nature of Article XI of the BIT, the committee observed that: first, the tribunal held exclusive power to determine the probative value of any evidence, and a decision to downplay some evidence or dismiss it as irrelevant did not indicate a failure to assess it; and second, the tribunal had assessed the evidence in light of the Vienna Convention on the Law of Treaties. It therefore could not be said that the tribunal had manifestly exceeded its powers or had failed to state reasons.

With respect to Argentina's customary international law defense, the committee observed that the tribunal had viewed the exceptions clause in Article XI of the BIT as a *lex specialis*; and as such, the tribunal had reasoned that the customary international law defense would only apply if the treaty defense did not apply. As the tribunal had found that the treaty defense did apply, the committee found that the tribunal's decision not to review the customary international law defense was sufficiently well-reasoned so as not to manifestly exceed its powers.

On Article IV(3) of the BIT, while arbitrators in another ICSID case had interpreted an equivalent provision in a different manner, the ad-hoc committee noted that the El Paso tribunal was not bound by other case-law, and could freely give its own interpretation of the clause (and ultimately find it inapplicable to the El Paso case).

Jurisdiction: distinction between direct and indirect investments

The committee also reviewed Argentina's application to annul the award on the basis of errors in the tribunal's findings on jurisdiction.

Notably, Argentina argued that the tribunal had "amended" El Paso's claim seeking recovery for both direct and indirect investments to make it viable. The committee, however, found that Argentina had not shown how the tribunal "amended" El Paso's claim and the committee could therefore not agree that the tribunal manifestly exceeded its power.

Argentina also claimed that the tribunal had failed to

state reasons as to why it was exercising jurisdiction over contracts and licenses held by the Argentine companies owned partially by El Paso, i.e. El Paso's indirect investments. However, the committee found that it could not entertain such a claim as it would entail either analyzing the merits or adjudicating alleged errors on the merits.

Damages: Reference to Chorzow Factory case-law

Finally, Argentina claimed that the tribunal, in relying on the *Chorzow Factory* standard for calculating damages, had manifestly exceeded its powers as case-law does not constitute a source of international law.

The committee, however, observed that as the BIT itself was silent on the applicable standards of damages the tribunal enjoyed discretion in this respect. Moreover, while case-law is not strictly a source of international law, it could nevertheless be used as a basis of reasoning.

The committee was composed of Ms Teresa Cheng, Mr Rolf Knieper, and Mr Rodrigo Orearuno (President).

The decision is available at: http://www.italaw.com/sites/default/files/case-documents/italaw4007_0.pdf

resources and events

Resources

The IISD Guide to Negotiating Investment Contracts for Farmland and Water

By Carin Smaller, published by the International Institute for Sustainable Development, November 2014

The IISD Guide to Negotiating Investment Contracts for Farmland and Water is a legal and policy tool for governments and communities that are involved in negotiating investment contracts with foreign investors. The guide focuses on a particular type of contract involving long-term leases of farmland. Part I, *Preparing for Negotiations*, is designed to assist in the preparatory phase. Part 2, *Model Contract*, is structured like an investment contract for the lease of farmland and proposes model provisions. The IISD guide is a proactive response to the 'land grab' phenomenon that has plagued many countries in Sub-Saharan Africa and South East Asia in recent decades, whereby an unprecedented number of foreign investors acquire land in developing countries for their own financial gain, often to the detriment of poor farmers and pastoralists. The guide is available here: <http://www.iisd.org/publications/iisd-guide-negotiating-investment-contracts-farmland-and-water>

Foreign Investment in the Energy Sector: Balancing Private and Public Interests

Edited by Eric De Brabandere and Tarcisio Gazzini, published by Brill, June 2014

Foreign investments in the energy sector raise formidable legal questions, often requiring a delicate balance between private and public interests of the various stakeholders. *Foreign Investment in the Energy Sector: Balancing Private and Public Interests* opens with a discussion of the legal protection of foreign investment in the main segments of the energy sector (namely oil, gas, mining and hydroelectric industry), both in substantive and procedural terms. The second part of the book focuses on the Energy Charter Treaty, by far the most important international legal instrument in the energy sector, and its future after the decision of the Russian Federation not to ratify it. In its third part, the book examines four critical areas that are often negatively concerned by economic activities by multinational in the energy sector, namely compliance with safety and labour standards, protection of the environment, respect of indigenous peoples rights, and protection of public health. The book is available for purchase here: <http://www.brill.com/products/book/foreign-investment-energy-sector>

Piercing the Veil of State Enterprises in International Arbitration

By Albert Badia, published by Wolters Kluwers, March 2014

State enterprises are separate and legally independent from the state and should therefore be treated in the same manner as private corporations: neither privileged nor disadvantaged. However, the records of international arbitration show that the corporate veil of state enterprises has rarely, if ever, been pierced. This important book asks why this is so, and takes a giant step towards establishing the circumstances under which the rules of international law may allow piercing the veil of state corporate enterprises. To answer the questions of how far we should go in holding states responsible for the acts of their enterprises, and which principles should be applied, the author focuses on the theory of state attribution, ultimately concluding that, when it comes to enterprises owned or controlled by states, veil-piercing constitutes a special form of attribution. The book is available for purchase here: <http://www.kluwerlaw.com/Catalogue/titleinfo.htm?ProdID=9041151621>

The Foundations of International Investment Law: Bringing Theory into Practice

Edited by Zachary Douglas, Joost Pauwelyn, and Jorge E. Viñuales, published by Oxford University Press, May 2014

International investment law is one of the fastest growing areas of international law. It has led to the signing of thousands of agreements, mostly in the form of investment contracts and bilateral investment treaties. Also, in the last two decades, there has been an exponential growth in the number of disputes being resolved by investment arbitration tribunals. Yet the

legal principles at the basis of international investment law and arbitration remain in a state of flux. Perhaps the best illustration of this phenomenon is the wide disagreement among investment tribunals on some of the core concepts underpinning the regime, such as investment, property, regulatory powers, scope of jurisdiction, applicable law, or the interactions with other areas of international law. The purpose of this book is to revisit these conceptual foundations in order to shed light on the practice of international investment law. It is an attempt to bridge the growing gap between the theory and the practice of this thriving area of international law. The first part of the book focuses on the 'infrastructure' of the investment regime or, more specifically, on the structural arrangements that have been developed to manage foreign investment transactions and the potential disputes arising from them. The second part of the book identifies the common conceptual bases of an array of seemingly unconnected practical problems in order to clarify the main stakes and offer balanced solutions. The third part addresses the main sources of 'regime stress' as well as the main legal mechanisms available to manage such challenges to the operation of the regime.

Events 2014

November 21-22

WORKSHOP ON THE (COMPARATIVE) CONSTITUTIONAL LAW OF PRIVATE-PUBLIC ARBITRATION, Max Planck Institute for Comparative Public Law and International Law, Heidelberg, Germany, http://www.mpil.de/en/pub/organization/lex_mp.cfm

November 28

OIL, GAS AND RENEWABLE ENERGIES INVESTMENT PROJECTS: INTERACTION BETWEEN RULES OF LAW AND ARBITRATION, Milan Chamber of Commerce, Milan, Italy, <http://www.camera-arbitrale.it/it/news/V+CAM+Annual+Conference+.php?id=521>

December 5

CLE WORKSHOP ON INVESTMENT ARBITRATION AND HUMAN RIGHTS, The Columbia Center on Sustainable Investment, New York, United States, <http://ccsi.columbia.edu/2013/12/17/cle-workshop-on-investment-arbitration-and-human-rights/>

December 8-9

THE POLITICAL ECONOMY OF INTERNATIONAL INVESTMENT AGREEMENTS, German Development Institute and International Investment Initiative of the World Trade Institute, Bonn, Germany, <http://www.die-gdi.de/veranstaltungen/internationalinvestment-agreements/>

Events 2015

February 5

2ND ICC INTERNATIONAL MEDIATION ROUND TABLE, International Chamber of Commerce, Paris, France, <http://www.iccwbo.org/training-and-events/competitions-and-awards/mediation-week/>

February 16-20

EXPERT MEETING ON THE TRANSFORMATION OF THE INTERNATIONAL INVESTMENT AGREEMENT REGIME: THE PATH AHEAD, UNCTAD, Geneva, Switzerland, <http://unctad.org/en/pages/MeetingDetails.aspx?meetingid=643>

March 9-14

EXECUTIVE TRAINING PROGRAM ON SUSTAINABLE INVESTMENTS IN AGRICULTURE, Columbia University, New York, United States, <http://ccsi.columbia.edu/2012/03/16/agtraining/>



Investment Treaty News Quarterly is published by the International Institute for Sustainable Development. The views expressed in this publication do not necessarily reflect those of the IISD or its funders, nor should they be attributed to them.

IISD contributes to sustainable development by advancing policy recommendations on international trade and investment, economic policy, climate change and energy, measurement and assessment, and natural resources management, and the enabling role of communication technologies in these areas. We report on international negotiations and disseminate knowledge gained through collaborative projects, resulting in more rigorous research, capacity building in developing countries, better networks spanning the North and the South, and better global connections among researchers, practitioners, citizens and policy-makers.

IISD's vision is better living for all—sustainably; its mission is to champion innovation, enabling societies to live sustainably. IISD is registered as a charitable organization in Canada and has 501(c)(3) status in the United States. IISD receives core operating support from the Government of Canada, provided through the Canadian International Development Agency (CIDA), the International Development Research Centre (IDRC) and Environment Canada, and from the Province of Manitoba. The Institute receives project funding from numerous governments inside and outside Canada, United Nations agencies, foundations and the private sector.

The ITN Quarterly welcomes submissions of unpublished, original works. Requests should be sent to Damon Vis-Dunbar at itn@iisd.org

To subscribe to the ITN Quarterly, please visit:
https://lists.iisd.ca/read/all_forums/subscribe?name=itn-english

International Institute for Sustainable Development
International Environment House 2
9, Chemin de Balaxert,
5th Floor, 1219, Chatelaine,
Geneva, Switzerland

Tel: +41 22 917-8748
Fax: +41 22 917-8054
Email: itn@iisd.org