



International Investment Law and Sustainable Development: Key cases from the 2010s

Authored by
Stefanie Schacherer

Editing by
Nathalie Bernasconi-Osterwalder
and Martin Dietrich Brauch

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October 2018

Author

Stefanie Schacherer, LL.M., is a dual Ph.D. candidate at the University of Geneva and the University of Vienna. She currently works as a Teaching and Research Assistant at the Department of Public International Law and International Organization at the University of Geneva.

Editors

Nathalie Bernasconi-Osterwalder, LL.M., is a senior international lawyer and Group Director of the Economic Law and Policy Program of the International Institute on Sustainable Development (IISD).

Martin Dietrich Brauch, LL.M., is an international law adviser and associate with IISD, as well as editor-in-chief of IISD's Investment Treaty News (ITN).

Head Office

111 Lombard Avenue, Suite 325
Winnipeg, Manitoba
Canada R3B 0T4

Tel: +1 (204) 958-7700

Website: www.iisd.org

Twitter: @IISD_news

Editors' Preface

In 2011, the International Institute for Sustainable Development (IISD) published *International Investment Law and Sustainable Development: Key cases from 2000–2010*. The e-book features 17 summaries and analyses of decisions rendered by arbitral tribunals in treaty-based investor–state arbitration cases having sustainable development implications.¹

This e-book, a companion volume to the 2011 publication, carries out the same exercise, now focusing on 10 investment arbitration cases decided in the 2010s. Looking at these cases through a sustainability lens, Stefanie Schacherer illustrates the complex relationship between international investment law and sustainable development.

The 10 cases were selected based on their relevance for a range of issues relating to sustainable development, including environmental protection, socio-environmental impact assessment, renewable energy, taxation, corruption and human rights. The cases also highlight fundamental legal issues and current debates in international investment law, such as the notion of legitimate expectations and the related balancing of public versus private rights, the amount of compensation awarded for actions taken by states that affect the bottom line of investors, and the increasing trend to push for responsible investment by holding foreign investors accountable for their actions in the host state.

Along with the publication of this e-book, IISD is publishing the 27 summaries of both volumes on the website of [Investment Treaty News](#) (ITN), IISD's online journal on international investment law and policy, which regularly publishes case summaries of international arbitrations.²

Through the compilation of analyzed cases, IISD aims at contributing to a broader debate on the reform of international investment law and policy, with the aim of ensuring that foreign investment contributes to sustainable development.

Nathalie Bernasconi-Osterwalder

Group Director, Economic Law and Policy Program

Martin Dietrich Brauch

Associate and International Law Adviser, Economic Law and Policy Program
Editor-in-Chief, Investment Treaty News

1 Bernasconi-Osterwalder, N. & Johnson, L. (Eds.). (2011, July). *International investment law and sustainable development: Key cases from 2000–2010*. Geneva: International Institute for Sustainable Development (IISD). Retrieved from <https://www.iisd.org/library/international-investment-law-and-sustainable-development-key-cases-2000-2010>

2 <http://www.iisd.org/itn/isds-investment-arbitration-sustainable-development>

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Introduction

In the last several years, sustainable development has become the global paradigm guiding the ongoing reform of international investment law. Several model international investment agreements (IIAs) have been adopted that place sustainable development at their core and enshrine treaty provisions aimed at achieving a better balance between the public policy interest of states and the private interests of foreign investors. Some countries and regions have already concluded IIAs based on such models.

Despite this recent paradigm shift in treaty drafting, international investment law is still composed of traditional IIAs whose main function is to prescribe how host states treat foreign investors. They provide for broad and vaguely worded substantive protection standards for foreign investors, as well as for investor–state dispute settlement (ISDS) through international arbitration. Consequently, investment arbitrators are still important actors in defining and articulating the relationship between international investment law and sustainable development. Investment case law over the last 25 years has shown that tribunals have ample powers to interpret the scope and meaning of states’ obligations under IIAs. They decide to what extent IIAs limit states’ right to regulate and their ability to adopt and maintain policies to promote sustainable development.

Therefore, to understand the relationship between the international investment regime and the objective of achieving sustainable development, one needs to look beyond the text of IIAs and examine awards in treaty-based investment arbitration cases. International dispute settlement does not operate in a vacuum, and neither does ISDS, which has been subject to strong criticism over the past few years.³

Has investment arbitration changed in light of this criticism? Do arbitrators increasingly consider sustainable development when interpreting IIAs? Do they advance legal concepts that seek to better balance public and private interests, such as the police power doctrine? Do they interpret international law systemically, integrating other fields, such as international human rights law? What levels of due diligence do tribunals expect of investors, and how can that impact the investors’ claim? What degree of deference do tribunals accord to a state measure adopted in order to foster sustainable development? The analysis of arbitration cases in this volume aims at elucidating these questions.

The selection of 10 key cases for this book has been made based on investment disputes that have implications for sustainable development, in its three dimensions: economic development, social development and environmental protection. The cases include investment activities that have impacts in the host country, such as on the environment, on the local population (including certain minorities) as well as on social rights (including matters of public health and human rights).

3 The ISDS regime has recently attracted strong and growing criticisms in various parts of the world. See UNCTAD. (2017). *World Investment Report 2017, Investment and the digital economy*. Retrieved from <https://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=1782>, pp. 123–124. See also UNCITRAL. (2017). *Possible reform of investor–state dispute settlement (ISDS)*, Note by the Secretariat, A/CN.9/WG.III/WP.142. Retrieved from <https://documents-dds-ny.un.org/doc/UNDOC/LTD/V17/067/48/PDF/V1706748.pdf?OpenElement>, para. 11.



States' Substantive Obligations Under Investment Treaties

The majority of cases included in this book specifically involve situations in which the allegedly wrongful act of the host state consisted of new legislation adopted as a matter of public policy, such as health, environmental protection, economic development and taxation. Two investment protection standards clash with the regulatory autonomy of host states in most cases: (i) fair and equitable treatment (FET) and the protection of investors' legitimate expectations and (ii) indirect expropriation. In fact, several cases in this book illustrate once more the broad discretion that many tribunals adopt in circumscribing the regulatory autonomy of states.

Depending on the tribunal's interpretation, a focus on the investors' (legitimate) expectations may have a negative impact on the state's ability and willingness to develop its regulatory framework (for example, *Bilcon v. Canada* and *Eiser v. Spain*). In other cases, tribunals have been more deferential, acknowledging the state's policy space and need to regulate for public policy reasons (for example in *Philip Morris v. Uruguay*), though it is unclear if the same tribunal would have come to a different conclusion in a case not involving an issue as clear-cut as the effect of tobacco on health.

The different cases analyzed also show that indirect expropriation remains a treaty standard with unpredictable interpretative outcomes (for example, *Burlington v. Ecuador* and *Crystallex v. Venezuela*). Even where the indirect expropriation provision is accompanied by an annex containing interpretative guidance, tribunals still employ wide discretion as to their application, as illustrated by the *Bear Creek v. Peru* award.

Responsible Investment and the Emergence of Investor Obligations

Host states increasingly seek to bring the wrongful behaviour of investors before an arbitral tribunal, no longer merely defensively but in the form of counterclaims. In the cases of *Urbaser v. Argentina* and *Burlington v. Ecuador*, the tribunals affirmed their jurisdiction to hear the states' counterclaims. On a substantive level, the *Urbaser* tribunal considered that companies could bear human rights obligations under international law. However, it ultimately did not hold the investor liable for not effectively ensuring the human right to water, reasoning that, in this case, related international obligations applied to states only.

Investor behaviour also plays a role in cases where the investment has been established or operated in a context of corruption or fraud. The tribunals in two of the analyzed cases (*Churchill Mining v. Indonesia* and *Metal-Tech v. Uzbekistan*) held that investors operating in countries with a relatively weak adherence to the rule of law must act with due diligence. Negligent behaviour or wilful blindness as well as participation in corrupt practices have resulted in either the inadmissibility of the investor's claim or the loss of access to international arbitration.

Public Participation Through Amicus Curiae Submissions

Public participation is a fundamental element of sustainable development. Within international investment arbitration, the current general belief is that the issue of amicus curiae participation is no longer controversial, as tribunals have often admitted amicus briefs in several cases (for example, *Philip Morris v. Uruguay*). However, other cases analyzed here show that tribunals do not always accept amicus briefs (*Bear Creek v. Peru*) and that, even when they do accept a third-party submission, they may still choose to overlook its arguments (*Pac Rim v. El Salvador*).

The Amount of Compensation

Another important aspect of ISDS is that arbitral decisions can result in large damage awards, which are especially burdensome for developing countries. In particular, with respect to early-stage investment projects, the standard reliance on the discounted cash flow (DCF) method has become highly controversial. This method considers future profits generated by a project, which are, in the case of a project that has not started to operate, speculative and uncertain. Among the analyzed cases, the tribunal in *Crystallex v. Venezuela* calculated the damages for a mine that had not started to operate by using the DCF method. In the more recent *Bear Creek v. Peru* case, which also related to a mine that was not yet in operation, the tribunal decided to apply the sunk costs approach, considering the actually invested amounts only.

Bear Creek Mining Corporation v. Republic of Peru, ICSID Case No. ARB/14/2 (Bear Creek v. Peru)

Decisions and award are available at <https://www.italaw.com/cases/2848>

Keywords: silver mining, general exception clause, social licence to operate,
human rights and rights of Indigenous Peoples

Key Dates:

Request for arbitration: August 11, 2014

Constitution of tribunal: December 3, 2014

Partial dissenting opinion of Philippe Sands: September 12, 2017

Award: November 30, 2017

Arbitrators:

Karl-Heinz Böckstiegel (president)

Philippe Sands (respondent appointee)

Michael Pryles (claimant appointee)

Forum and Applicable Procedural Rules:

International Centre for Settlement of Investment Disputes (ICSID)

ICSID Rules of Procedure for Arbitration Proceedings

Applicable Treaty:

Free Trade Agreement between Canada and the Republic of Peru

Alleged Treaty Violations:

- Expropriation
- Fair and equitable treatment
- Full protection and security
- Protection against unreasonable or discriminatory measures

Other Legal Issues Raised:

- General exception clause
- Jurisdiction
- Lawfulness requirement of an investment

1.0 Importance for Sustainable Development

The *Bear Creek v. Peru* arbitration illustrates the extent to which it is important that foreign investors as well as the host state engage in public consultation and outreach with the local population to guarantee that investment projects are well received and viewed positively. Canadian investor Bear Creek had found indications of significant silver ore deposits in the Santa Ana mine in Peru, but was ultimately barred from pursuing the exploitation of the mine due to the significant mistrust of the local population toward the project and the investor, which culminated in violent protests and social unrest. Bear Creek thus did not have a *social licence to operate* its investment. The concept of social licence is not a legal requirement but expresses the acceptance of a local population and other stakeholders about an economic project based on their perceptions and opinions.

The majority of the *Bear Creek* tribunal agreed that it is mainly up to host states to establish a legal framework that allows efficient consultation processes with the local population. However, one dissenting arbitrator argued that the foreign investor also plays an important part in this process of obtaining local trust—that is, the social licence. Namely, the dissenter found that International Labour Organization (ILO) Convention 169 (concerning Indigenous and Tribal Peoples) had legal effects on foreign investors as well. The dissenting arbitrator seems to continue a trend, illustrated by *Urbaser v. Argentina*,⁴ to increase the international accountability of foreign investors with respect to certain social and human rights obligations. These cases also underline the fact that the need for corporate liability is gaining more attention, and tribunals must provide more space for considerations of human rights in investment disputes.

The number of cases dealing with the interaction between investment protection and the rights of Indigenous communities is increasing. Other pending cases include *Álvarez y Marín Corporación S.A. and others v. Panama* (involving claims of invasion of the investors' properties by Indigenous groups) and *South American Silver Limited v. Bolivia* (involving claims of an investor's misconduct in its relationship with local communities near a mining project).

The *Bear Creek* award, moreover, highlights another interesting development in recent investment arbitral case law, relating to the calculation of damages for investments that had not yet begun to operate. The tribunal accepted the sunk costs approach and refused to apply the discounted cash flow (DCF) method given that the future profitability of the investment was uncertain. This approach had also been applied by the tribunal in *Copper Mesa v. Ecuador*.⁵

4 *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. The Argentine Republic*, ICSID Case No. ARB/07/26. Retrieved from <http://www.italaw.com/cases/1144>.

5 *Copper Mesa Mining Corporation v. Republic of Ecuador*, PCA No. 2012-2. Retrieved from <https://www.italaw.com/cases/4206>.

2.0 Case Summary

2.1 Factual Background

Bear Creek Mining Corporation (Bear Creek), a Canadian company, sought to invest in Peru for the development of the Santa Ana silver mine, located in the Puno Region near the border with Bolivia. According to the Peruvian constitution, mines situated within the border zone of 50 km require explicit authorization from the Peruvian executive. A Peruvian national and employee of Bear Creek had originally acquired the mining rights. Bear Creek only later applied for the mining rights in its own name.

In November 2007, through Supreme Decree 083-2007 (Decree 083), Bear Creek obtained authorization to acquire, own and operate the corresponding mining concessions (para. 149). From 2007 onward, Bear Creek engaged in promising exploration work in the Santa Ana mine and conducted an environmental and social impact assessment (ESIA). Peruvian authorities approved the ESIA in 2011 but instructed the investor to implement community participation mechanisms to evaluate the ESIA (para. 168).

However, local communities strongly opposed the development of the Santa Ana mine, including through violent protests (paras. 190 et seq.). The concerns of the local population were that the mining activity of Bear Creek would negatively affect their land and thereby their cultural identity. In June 2011, the newly elected government, in an attempt to deal with the social unrest in the Puno region, issued Supreme Decree 032-2011 (Decree 032), which revoked Supreme Decree 083 (para. 202). Decree 032 had the effect of shuttering the mining project.

2.2 Summary of Legal Issues and Decisions

In August 2014, Bear Creek filed a claim against Peru under the Canada–Peru Free Trade Agreement (FTA). It argued that Decree 032 breached the requirements of the FTA, namely, to protect investors against unlawful expropriation, to afford them fair and equitable treatment (FET), to grant them full protection and security and to not impair the investment with unreasonable and discriminatory measures (para. 113). The investor claimed damages of USD 522 million, representing the expected profitability of the Santa Ana project. Peru, in turn, argued that the tribunal lacked jurisdiction given that the investment was made in bad faith and in violation of domestic laws. Moreover, the tribunal received three *amicus curiae* applications, of which two were accepted (brought by a Peruvian human rights organization and a Peruvian lawyer) and another (brought by an American think tank) which was rejected with the argument that it had not sufficiently been shown that it would be able to contribute any further information or arguments that would assist the tribunal (Procedural Order No. 6, para. 38). This raises questions about the discretion given to tribunals regarding the acceptance of *amicus* briefs.

In its award, the tribunal rejected the jurisdictional objections raised by Peru and accepted that Bear Creek must be compensated for the unlawful expropriation of its investment by Peru. The tribunal declined to make any finding on the investor's additional FTA claims, reasoning that any such finding would not change or add to those that follow from the finding of expropriation. While accepting that there had been an indirect expropriation, the tribunal did not follow Bear Creek's reasoning on the amount of damages claimed, awarding it sunk costs only.

3. Select Legal Issues

3.1 Legality Requirement of Investment is Not Part of General International Law

Peru objected to the tribunal's jurisdiction, claiming that Bear Creek had violated domestic laws when it obtained Decree 083 through an employee of the company who originally acquired the mining rights. According to Peru, this behaviour was in breach of constitutional law and could not be cured by a subsequent approval (para. 306). The respondent based the legality requirement of the investment not on a specific provision in the FTA but argued that it was part of the "*corpus* of international law and persuasive international arbitration jurisprudence" (para. 302, emphasis in original).

In its analysis of the jurisdictional objections relating to the alleged illegal conduct by the investor in obtaining Decree 083 and operating the investment, the tribunal looked at the language of the FTA to assess whether it contained any preconditions for a finding of jurisdiction based on the legality of the investment. In fact, FTA Article 816 provides that the host state is free to "prescribe special formalities in connection with the establishment of covered investments." The tribunal concluded that Peru did not make use of this latter option and that the FTA does not contain an explicit requirement for investments to be made in compliance with domestic law (para. 319). The tribunal thus declined to read such requirement into the FTA or to base it on general international law.

3.2. Tribunal Finds an Indirect Expropriation

One of Bear Creek's central claims was that Decree 032 constituted an indirect expropriation of its investment. Like many of the recently concluded international investment agreements (IIAs), the FTA between Canada and Peru contains an express provision on indirect expropriation (Article 812.1), further detailed in footnotes to the article and in a specific annex (para. 372). FTA Annex 812.1 sets out four factors that a tribunal should examine in order to determine whether a measure constitutes an indirect expropriation.

The first factor refers to the economic impact of the expropriatory measure. The tribunal found that "there was an obvious economic impact" which had deprived the investor of all major rights it had obtained through Decree 083 (para. 375). In other words, because Bear Creek could not lawfully do anything with the Santa Ana project, the value of the investment had been substantially compromised.

With respect to the second factor, it found that Decree 032 had also interfered with the investor's reasonable expectations to develop its project based on the express governmental authorization it had acquired through Decree 083 (para. 376). According to the tribunal, Bear Creek would not have invested the amounts it invested without such authorization issued by Peru.

The third factor—the “character of the measure”—required a more comprehensive analysis of Decree 032. In this respect, the tribunal engaged in a fact-finding exercise, analyzing, in particular, the circumstances under which the decree was adopted. It highlighted four factual elements. First, the authorities met on June 23, 2011 without inviting the investor to participate. Second, the evidence upon which Decree 032 was issued was not produced in the arbitration; it was therefore not possible to assess the reasonableness of the revocation. Third, given that the government knew about and approved the participation of the employee of Bear Creek in the authorization procedure, the employee's involvement could not have constituted a legal justification to revoke Decree 083. Fourth, the social unrest in the area was not caused by the investor's conduct, which was repeatedly endorsed by governmental authorities.

As to the fourth factor, Peru had claimed that the reason for the revocation of Bear Creek's mining rights was the social unrest in the region. The tribunal agreed with the respondent that the claimant could have gone further in its outreach activities to the local population to obtain the social licence but stressed that the issue was whether additional outreach by the investor was legally required (para. 408), which the tribunal ultimately denied. According to the tribunal, Bear Creek could take for granted that it complied with all legal requirements as the respondent continuously approved and supported the investor's conduct (para. 412). Given all these elements, the tribunal held that Decree 032 constituted an indirect expropriation.

3.3 General Exceptions Clause v. Police Powers?

To deny the existence of an indirect expropriation, Peru raised the doctrine of police powers, justifying that the revocation of the mining rights was a legitimate reason to ensure public security (para. 460). Interestingly, the tribunal treated the police power argument as an exception to an FTA breach rather than as negating the existence of an expropriation. In doing so, the tribunal prioritized the parties' arguments based on the general exception clause contained in FTA Article 2201. This provision sets out an exhaustive list of three exceptions to breaches of the investment chapter of the FTA.⁶ The tribunal held that “the interpretation of the FTA must lead to the conclusion that no other exception from general international

⁶ Article 2201.1 of the FTA provides for the following “Exceptions”:

3. For the purposes of Chapter Eight (Investment), subject to the requirement that such measures are not applied in a manner that constitute arbitrary or unjustifiable discrimination between investments or between investors, or a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures necessary:

(a) to protect human, animal or plant life or health, which the Parties understand to include environmental measures necessary to protect human, animal or plant life or health;
(b) to ensure compliance with laws and regulations that are not inconsistent with this Agreement; or
(c) the conservation of living or non-living exhaustible natural resources.

law or otherwise can be considered applicable in this case” (para. 473), thus excluding the application of the police powers doctrine. Applying the general exception clause to the fact, the tribunal underlined that nothing in Decree 032 referred to any of the reasons allowing an exception under FTA Article 2201.

3.4 Tribunal Awards Sunk Costs Only

With respect to the damages to be awarded to Bear Creek, the tribunal held that the damages should not be calculated by relying on the potential profitability of the investment calculated through the DCF method. Based on the test for early-stage projects in the *Vivendi v. Argentina II* award,⁷ the tribunal concluded that the claimant did not produce sufficient “convincing evidence of its ability to produce profits in the particular circumstances it faced” (para. 601). In sum, the tribunal found that the project remained too speculative and uncertain to allow the DCF method to be applied, the damages should consequently be calculated by reference to the amounts actually invested by Bear Creek, the so-called sunk costs. The tribunal finally awarded USD 18,237,592.

3.5 The Contributory Fault of Investor and the Amount of Damages

Peru reiterated its argument that Bear Creek had contributed to the social unrest and therefore the amount of damages should be reduced. On the issue of contributory fault of the investor, there was considerable disagreement between the members of the tribunal, which led co-arbitrator Philippe Sands to issue a partial dissenting opinion (para. 663).

In his dissenting opinion, Sands agreed with Peru that the assessment of damages should be reduced because the protests and social unrest were a result of the Santa Ana project (dissent, para. 1). Sands referred to the International Labour Organization’s Indigenous and Tribal Peoples Convention (ILO Convention 169) to assess the investor’s behaviour with respect to the local population. While he acknowledged that the convention imposes direct obligations only on states and not on foreign companies, he argued that this would not mean that the convention was “without significance or legal effects” for private companies (dissent, para. 10). According to Sands, the ILO Convention requires states to deliver a domestic law framework that ensures effective consultation processes and outcomes, but it is ultimately for “the investor to obtain a ‘social license’ out of those processes” (dissent, para. 37). He concluded that Bear Creek failed to engage the trust of all potentially affected communities and that, although the claimant was aware of those communities, it failed to take the appropriate steps to address their concerns. For these reasons, he suggested that the amount of damage should be cut in half, taking into account Bear Creek’s contributory fault.

⁷ *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic*, ICSID Case No. ARB/97/3, Award, August 20, 2007, paras. 8.3.4., 8.3.8, 8.3.10. Retrieved from <https://www.italaw.com/cases/309>.

Eiser Infrastructure Limited and Energia Solar Luxembourg S.à.r.l v. Kingdom of Spain, ICSID Case No. ARB/13/36 (Eiser v. Spain)

The award is available at <https://www.italaw.com/cases/5721>

Keywords: energy transition, feed-in tariffs, legitimate expectations, legal stability

Key dates:

Request for arbitration: December 9, 2013

Constitution of tribunal: July 8, 2014

Award: May 4, 2017

Annulment: pending

Arbitrators:

John R. Crook (president)

Campbell McLachlan (respondent appointee)

Stanimir A. Alexandrov (claimant appointee)

Forum and applicable procedural rules:

International Centre for Settlement of Investment Disputes (ICSID)

ICSID Rules of Procedure for Arbitration Proceedings

Applicable Treaty:

Energy Charter Treaty (ECT)

Alleged Treaty Violations:

- Expropriation
- Fair and equitable treatment
- Impairment by unreasonable measures
- Umbrella clause

Other Legal Issues Raised:

- Calculation of damages
- Jurisdiction—no jurisdiction over taxation measures
- Jurisdiction—cooling-off period
- Jurisdiction—objection in amicus curiae brief of the European Commission

1. Importance for Sustainable Development

The energy transition from fossil fuels to renewable resources is at the centre of sustainable development. The United Nations Sustainable Development Goal (SDG) 7 calls for an increase in the share of renewable energy worldwide, and most states have adopted legislation to promote its implementation. Foreign direct investment (FDI) is an important tool for the shift to renewable energy production. This typically includes subsidies and fiscal advantages and other incentives for investors. Notwithstanding this general trend, in response to the economic crises in several countries, a number of governments have revoked or reduced their support to renewable energy and modified the legal regime applicable to renewables.

These regulatory changes have provoked a wave of claims by foreign investors active in the field of renewable energy. The Czech Republic, Italy⁸ and Spain are facing most of such claims, which are all based on the Energy Charter Treaty (ECT). The common strand between these cases is that all the three countries adopted ambitious legislation to promote investments in the renewable energy sector. Yet due to the important budgetary implications for the states they subsequently changed the legislation in place and revoked the advantages. (See Section 4 for an overview of the cases.)

Spain is facing the largest number of claims, counting 41 as of September 18, 2018.⁹ The first case lodged against Spain was in 2011 by *PV Investors*. The first publicly available award in an energy case against Spain was *Charanne*, lodged in 2012. In this case, Spain prevailed. However, the cases lodged against Spain after the entry into force of Law 15/2012 in 2013 have tended to have different outcomes because this law arguably had the most severe impacts on foreign investors.

Spain has also prevailed in *Isolux v. Spain*, the first decision concerning Law 15/2012.¹⁰ The Isolux tribunal concluded that Spain did not breach the fair and equitable (FET) standard because, when Isolux decided to invest in Spain, the regulatory framework for renewable energy had already been modified and was undergoing several studies that made its modification inevitable. In addition, according to the tribunal, Isolux had knowledge of Spanish domestic case law allowing the government to modify the regulatory framework while guaranteeing a reasonable return on investment to the investor. Consequently, the tribunal held that no reasonable investor could expect that this regulatory framework would remain unchanged. Moreover, the tribunal found that there was no expropriation of Isolux's investment either. By applying the test elaborated in the *Electrabel v. Hungary* case, the tribunal found that the loss of profitability suffered by Isolux after Spain's allegedly expropriatory measures was not enough as to constitute a substantial and significant deprivation of the investment. In sum, the *Isolux* tribunal dismissed all claims. This result is in contrast to the *Eiser* case, analyzed here, which was decided in favour of the investor.

8 First award against Italy was decided in favour of Italy, see *Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic*, ICSID Case No. ARB/14/3, Award of January 21, 2016. Retrieved from <https://www.italaw.com/cases/5739>.

9 UNCTAD, Investment Policy Hub. Retrieved from <http://investmentpolicyhub.unctad.org/ISDS>.

10 *Isolux Netherlands, BV v. Kingdom of Spain*, SCC Case V2013/153. Retrieved from <https://www.italaw.com/cases/5893>.

In order to compete with other energy sources, renewable energy power plants—including photovoltaic (PV)—sometimes require domestic incentives such as subsidies in the form of feed-in tariffs. These sorts of regimes were novel and in their infancy when Spain constructed its incentives scheme. This raises the issue of whether governments have the policy space to reform and adapt the subsidy schemes—in this case designed with a laudable sustainable development objective in mind—to address other pressing government objectives, i.e., dealing with a financial crisis. In this respect, the common question in all renewable energy cases is the extent to which governments can adapt regulatory regimes to new realities without breaching their obligation to accord FET to foreign investors.

A second question emerges regarding the effects of the renewable energy arbitral outcomes on other types of energy cases, including in areas that are harmful from a sustainable development perspective, such as the fossil fuel industry. The question arises whether cases such as *Eiser*, in which the investor prevailed, might provoke a regulatory chill, making states reluctant to adopt measures to address climate change and other environmental issues out of fear of getting sued at the international level. There is little doubt that the energy transition will be disruptive for foreign investors and the economy more broadly. With the implementation of the Paris Agreement on Climate Change, such disruptive measures will become more and more frequent.

2. Case Summary

2.1 Factual Background

Eiser Infrastructure Ltd. and Eiser Solar Luxembourg (Eiser) invested into three thermosolar plants in Spain in 2007 when Spain had adopted a very favourable renewable energy support scheme through Royal Decree (RD) 661/2007 (para. 108). RD 661/2007 provided for generous feed-in tariffs, especially for PV energy. Under the 2007 legislation tariffs were fixed at EUR 440/MWh. The adoption of RD 661/2007 caught the attention of many PV energy investors, including Eiser (para. 117). Spain did not anticipate the high number of solar developers that would take advantage of the offer and sell electricity to the grid leading to overproduction. The weak point of the Spanish regulation was that no cap was defined on how much capacity Spain would allow to benefit from the feed-in tariffs regime—and this failure imposed a high financial burden on Spain. The situation was further aggravated through the general financial and economic crisis of 2008. Consequently, the government started to adopt legislation that cut and retroactively imposed changes to the support schemes for PV energy.

The most drastic changes for PV energy producers (including Eiser) entered into force between 2012 and 2014. First, the Spanish Parliament adopted Law 15/2012, which imposed a 7 per cent tax on all energy producers. Royal Decree Law (RDL) 9/2013 introduced another important change in July 2013. This legislation repealed RD 661/2007 and thus eliminated the entire regime of fixed tariffs. For the PV energy producers this meant that their remuneration consisted of income from the sale of the energy at market price (para. 146). The definitive end of the RD 661/2007 regime was marked by Ministerial Order IET/1045/2014,

which introduced a new remuneration mechanism for renewable energy plants (para. 147). According to Eiser, at the end of 2014 the investment was worth EUR 4 million compared to an investment of EUR 125 million initially made in the establishment of the PV power plants (para. 154).

2.2 Summary of Legal Issues and Award

In addition to a violation of the fair and equitable treatment (FET) standard, the investors also invoked ECT Article 13 concerning expropriation, as well as the non-impairment standard and the umbrella clause of ECT Article 10(1) (para. 352). Yet for reasons of judicial economy, the tribunal decided to limit its analysis to the FET claim since the obligation “to accord investors fair and equitable treatment provides the most appropriate legal context for assessing the complex factual situation presented here” (para. 353). In conclusion, the tribunal found that Spain breached the FET standard as it frustrated Eiser’s legitimate expectations, and awarded the investor damages of EUR 128 million.

3. Select Legal Issues

3.1 Legitimate Expectation for a Stable Legal Framework

According to Eiser, its decision to invest in Spain was based on RD 661/2007. Yet it argued that Spain’s subsequent decision to replace the regulatory framework adopted in 2007 with a framework based on different assumptions violated its legitimate expectations protected under the ECT. As a consequence, it claimed that the value of its investment was reduced significantly. Spain, in contrast, argued that no investor can expect the “freezing or ‘unmodifiability’” of the 2007 regime. Spain added that it never made any promises or other specific commitments to Eiser that would rise to the level of legitimate expectations protected by the ECT.

The tribunal underlined that the state has the right to regulate and to modify regulatory regimes according to evolving circumstances, and that the FET standard would not lead to a right of investors to regulatory stability (para. 362). However, it found that the ECT protected Eiser “against total and unreasonable change that they experienced here” (para. 363). In the eyes of the tribunal, Eiser was an “experienced and sophisticated” investor, which meant for the tribunal that Eiser “recognized that regulatory regimes for utilities are sometimes adjusted, but within feasible limits” (para. 364).

To substantiate its findings, the tribunal first differentiated the present case from the previous *Charanne* case, where the RDL 9/2013 was not under scrutiny. Therefore the *Charanne* tribunal had to assess much less “sweeping” changes that had far less drastic economic consequences (para. 369). Second, the *Eiser* tribunal referred to a number of arbitral cases under the ECT emphasizing that, especially in the context of the ECT, host states were to provide a “stable, transparent legal framework for foreign investors” based on the preamble of the treaty as well as on a political document that was its precursor (paras. 377–380). Third, the tribunal held that the number of regulatory changes was significant and could lead to a breach

of FET. Lastly, the fact that the measures at issue transformed the regulatory framework entirely and the important financial losses for the investors were important elements for the tribunal.

In conclusion the tribunal adopted a standard according to which “Article 10(1) of the ECT entitled [Eiser] to expect that Spain would not drastically and abruptly revise the regime, on which their investment depended, in a way that destroyed its value. But this was the result of RDL 9/2013” and the subsequent measures adopted by Spain (para. 387).

3.2 Calculation of Compensation

Eiser argued that the appropriate measure to calculate its losses was the reduction of the fair market value of its investment as measured by the present value of past and future cash flows (para. 426). This method of valuation of losses is commonly called discounted cash flow (DCF) analysis. Eiser claimed losses of EUR 13 million (lost cash flows through June 2014) plus EUR 196 million (losses in cash flows projected over 40 years). Spain argued that the DCF method was inappropriate in the present case since the damages claimed by Eiser were “totally and completely speculative” (para. 435).

The tribunal considered the DCF method as “an appropriate means to determine the amount of reparation due in the circumstances of this case” (para. 441). It was persuaded by the argument that “[p]ower stations are relatively simple business, producing electricity, whose demand and long-run value can be analysed and modelled in detail based on readily available data. Moreover, the costs and operating performance of power stations are easy to predict” (para. 465). In conclusion, the tribunal agreed with Eiser that the future losses are of EUR 196 million but reduced this amount by EUR 68 million applying a risk-adjustment factor. Therefore, the final amount of compensation was EUR 128 million. The tribunal underlined that the sum of compensation was reasonable given that the claimant had invested EUR 126 million in its project.

4. Renewable Energy Cases as of September 18, 2018

Source: UNCTAD Policy Hub, <http://investmentpolicyhub.unctad.org/ISDS>

Cases against the Kingdom of Spain

1. *The PV Investors v. The Kingdom of Spain*, UNCITRAL, pending.
2. *Charanne B.V. and Construction Investments S.A.R.L. v. The Kingdom of Spain*, SCC, Arbitration No. 062/2012, Award of December 27, 2016.
3. *Isolux Infrastructure Netherlands B.V. v. The Kingdom of Spain*, SCC, Award of July 11, 2016.
4. *Novenergia v. The Kingdom of Spain*, SCC Case No. 063/2015, Award of February 15, 2017.
5. *Abengoa CSP Equity Investment S.à.r.l. v. The Kingdom of Spain*, SCC, pending.
6. *RREEF Infrastructure (G.P.) Limited & RREEF Pan-European Infrastructure Two Lux S.à.r.l. v. The Kingdom of Spain*, ICSID Case No. ARB/13/30, pending.
7. *Antin Infrastructure Services Luxembourg S.à.r.l. & Antin Energia Termosolar B.V. v. The Kingdom of Spain*, ICSID Case No. ARB/13/31, Award of June 15, 2018.
8. *Eiser Infrastructure Limited and Energia Solar Luxembourg S.à.r.l. v. The Kingdom of Spain*, ICSID Case No. ARB/13/36, Award of May 4, 2017.
9. *Masdar Solar & Wind Cooperatief UA v. The Kingdom of Spain*, ICSID Case No. ARB/14/01, Award of May 16, 2018.
10. *NextEra Energy Global Holdings B.V., NextEra Energy Spain Holdings B.V. v. The Kingdom of Spain*, ICSID Case No. ARB/14/11, pending.
11. *InfraRed Environmental Infrastructure G.P. Limited and others v. The Kingdom of Spain*, ICSID Case No. ARB/14/12, pending.
12. *REENERGY S.à.r.l. v. The Kingdom of Spain*, ARB/14/18, pending.
13. *RWE Innogy GmbH, RWE Innogy Aersa S.A.U. v. The Kingdom of Spain*, ARB/14/34, pending.
14. *Stadtwerke München GmbH v. The Kingdom of Spain*, ICSID Case No. ARB/15/01, pending.
15. *STEAG GmbH v. The Kingdom of Spain*, ICSID Case No. ARB/15/04, pending.
16. *9REN Holding S.a.r.l. v. The Kingdom of Spain*, ICSID Case No. ARB/15/15, pending.
17. *BayWa r.e. renewable energy GmbH, BayWa r.e. Asset Holding GmbH v. The Kingdom of Spain*, ICSID Case No. ARB/15/16, pending.
18. *Cube Infrastructure Fund SICAV v. The Kingdom of Spain*, ICSID Case No. ARB/15/20, pending.
19. *Mathias Kruck v. The Kingdom of Spain*, ICSID Case No. ARB/15/23, pending.
20. *KS Invest GmbH, TLS Invest GmbH v. The Kingdom of Spain*, ICSID Case No. ARB/15/25, pending.

21. *JGC Corporation v. The Kingdom of Spain*, ICSID Case No. ARB/15/27, pending.
22. *Cavalum SGPS, S.A. v. The Kingdom of Spain*, ICSID Case No. ARB/15/34, pending.
23. *E.ON SE, E.ON Finanzanlagen GmbH v. The Kingdom of Spain*, ICSID Case No. ARB/15/35, pending.
24. *OperaFund Eco-Invest SICAV PLC, Schwab Holding AG v. The Kingdom of Spain*, ICSID Case No. ARB/15/36, pending.
25. *SolEs Badajoz GmbH v. The Kingdom of Spain*, ICSID Case No. ARB/15/38, pending.
26. *Hydro Energy 1 S.à.r.l. and Hydroxana Sweden v. The Kingdom of Spain*, ICSID Case No. ARB/15/42, pending.
27. *Watkins Holdings S.à r.l. and others v. The Kingdom of Spain*, ICSID Case No. ARB/15/44, pending.
28. *Landesbank Baden-Württemberg and others v. Kingdom of Spain*, ICSID Case No. ARB/15/45, pending.
29. *Eurus Energy Holdings Corporation v. Kingdom of Spain*, ICSID Case No. ARB/16/04, pending.
30. *Alten Renewable Energy Developments BV v. Kingdom of Spain*, SCC, pending.
31. *Aharon Naftali Biram, Gilatz Spain SL, Redmill Holdings Ltd and Sun-Flower Olmeda GmbH v. Kingdom of Spain*, ICSID Case No. ARB/16/17, pending.
32. *Infracapital F1 S.à r.l. and Infracapital Solar B.V. v. Kingdom of Spain*, ICSID Case No. ARB/16/18, pending.
33. *Cordoba Beheer B.V., Cross Retail S.L., Sevilla Beheer B.V., Spanish project companies v. Kingdom of Spain*, ICSID Case No. ARB/16/27, pending.
34. *Portigon AG v. Kingdom of Spain*, ICSID Case No. ARB/17/15, pending.
35. *FREIF Eurowind v. Kingdom of Spain*, SCC Case No. 2017/060, pending.
36. *DCM Energy GmbH & Co. Solar 1 KG, DCM Energy GmbH & Co. Solar 2 KG, Edisun Power Europe A.G., Hannover Leasing Sun Invest 2 Spanien Beteiligungs GmbH, and Hannover Leasing Sun Invest 2 Spanien GmbH & Co. KG v. Kingdom of Spain*, ICSID Case No. ARB/17/41, pending.
37. *EDF Energies Nouvelles S.A. v. Kingdom of Spain*, UNCITRAL, pending
38. *Green Power K/S and Obton A/S v. Kingdom of Spain*, SCC Case No. 2016/135, pending.
39. *Foresight Luxembourg Solar 1 S.Á.R1., Foresight Luxembourg Solar 2 S.Á.R.L., Greentech Energy System A/S, GWM Renewable Energy I S.P.A and GWM Renewable Energy Ii S.P.A v. Kingdom of Spain*, SCC Case No. 2015/150, pending.
40. *Itochu Corporation v. Kingdom of Spain*, ICSID Case No. ARB/18/25, pending.
41. *Triodos SICAV II v. Kingdom of Spain*, SCC, pending.

Cases against the Republic of Italy

1. *Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v. Italian Republic*, ICSID Case No. ARB/14/3, Award of January 21, 2016.
2. *Ridge Power BV v. Italian Republic*, ICSID Case No. ARB/15/37, pending.
3. *Greentech Energy Systems and Novenergia v. Italian Republic*, SCC, pending.
4. *Eskosol S.p.A. in liquidazione v. Italian Republic*, ICSID Case No. ARB/15/50, pending.
5. *CEF Energia BV v. Italian Republic*, SCC, pending.
6. *Belenergia S.A. v. Italian Republic*, ICSID Case No. ARB/15/40, pending.
7. *ESPF Beteiligungs GmbH, ESPF Nr. 2 Austria Beteiligungs GmbH, and InfraClass Energie 5 GmbH & Co. KG v. Italian Republic*, ICSID Case No. ARB/16/5, pending.
8. *CIC Renewable Energies Italy GmbH, Enernovum Asset 1 GmbH & Co. KG, Enernovum GmbH & Co. KG and others v. Italian Republic*, ICSID Case No. ARB/16/39, pending.

Cases against the Czech Republic

1. *Antaris GmbH and Dr. Michael Göde v. Czech Republic*, UNCITRAL, PCA, pending.
2. *WA Investments-Europa Nova Limited v. Czech Republic*, UNCITRAL, pending.
3. *I.C.W. Europe Investments Limited v. Czech Republic*, UNCITRAL, pending.
4. *Mr. Jürgen Wirtgen, Mr. Stefan Wirtgen, and JSW Solar (zwei) GmbH & Co. KG v. Czech Republic*, UNCITRAL, pending.
5. *Natland Investment Group NV, Natland Group Limited, G.I.H.G. Limited, and Radiance Energy Holding S.A.R.L. v. Czech Republic*, UNCITRAL, pending.
6. *Photovoltaik Knopf Betriebs-GmbH v. Czech Republic*, UNCITRAL, pending.
7. *Voltaic Network GmbH v. Czech Republic*, UNCITRAL, pending.
8. *Fynerdale Holdings BV v. Czech Republic*, UNCITRAL, pending.
9. *Alcor Holding Ltd v. Czech Republic*, pending.

Burlington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5 (Burlington v. Ecuador)

Decisions and Award are available at <https://www.italaw.com/cases/181>

Keywords: taxation, investor obligations, environmental counterclaim

Key Dates:

Request for Arbitration: April 21, 2008

Constitution of Tribunal: February 18, 2009

Decision on Jurisdiction: June 2, 2010

Decision on Liability: December 14, 2012

Decision on the Proposal for Disqualification of Francisco Orrego Vicuña:
December 13, 2013

Decision on Ecuador's Counterclaims: February 7, 2017

Decision on Reconsideration and Award: February 7, 2017

Decision on Stay of Enforcement of the Award: August 31, 2017

Decision on Annulment: pending

Arbitrators:

Gabrielle Kaufmann-Kohler (president)

Brigitte Stern (respondent appointee)

Francisco Orrego Vicuña replaced by Stephen L. Drymer (claimant appointee)

Ad hoc Annulment Committee:

Andrés Rigo Sureda (president)

Piero Bernardini

Vera van Houtte

Forum and Applicable Procedural Rules:

International Centre for Settlement of Investment Disputes (ICSID)

ICSID Rules of Procedure for Arbitration Proceedings

Applicable Treaty:

United States–Ecuador Bilateral Investment Treaty (BIT)

Alleged Treaty Violations:

- Expropriation
- Umbrella clause

Other Legal Issues Raised:

- Jurisdiction
- Jurisdiction/merits—
environmental
counterclaim

1. Importance for Sustainable Development

The *Burlington v. Ecuador* case is factually linked to the case of *Perenco v. Ecuador*,¹¹ as both companies were part of the same consortium. Also, with respect to their importance for sustainable development, the cases highlight two interesting aspects. Both relate to the same Ecuadorean taxation measure, i.e., the “windfall tax” that was imposed on excess profits resulting from oil exploitation. Moreover, in both cases Ecuador filed a counterclaim against the investor.

First, with respect to the Ecuadorian windfall tax (known as Law 42) the tribunals of *Burlington* and *Perenco* came to the same conclusion as to find that the disputed measure did not constitute an expropriation. A majority of the *Burlington* tribunal added an interesting statement according to which it would be unlikely that a windfall tax would qualify as an expropriation because by definition, such a tax would appear not to have an impact upon the investment as a whole, but only a portion of the profits (decision on liability, para. 404). However, in the case of *Occidental v. Ecuador*,¹² where the investor also challenged the same tax measure (Law 42), the tribunal in *Occidental* arrived at a different conclusion. In a 2012 award, the same measure was found to amount to an unlawful expropriation. These cases demonstrate that there are uncertainties around the manner in which tribunals will address taxation issues, making it difficult for governments to predict the legality of taxation reform under investment treaties, and possibly causing governments to back away from reform. This is especially significant today as discussions around tax justice are at their height, and governments and international institutions have committed to fight tax avoidance and tax evasion.¹³

Second, discussions on counterclaims against investors are a prominent feature in the current discussion on reform of international investment law. The reason is that counterclaims can mitigate to some extent the asymmetry in investment arbitration since a state can, in the same proceedings, enforce social and environmental obligations against an investor. In both *Burlington* and *Perenco*, Ecuador filed counterclaims alleging that the companies’ activities resulted in significant environmental harm. While the decision on the counterclaim in the *Perenco* case is still pending, the *Burlington* tribunal has rendered a decision holding the investor liable. The *Burlington* case is thus also important because the tribunal considered the investor’s behaviour through the respondent’s counterclaim. Even though the investor’s obligations were mainly found in domestic law, the *Burlington* case may be relevant in future for the enforcement of investor obligations through international proceedings. The case demonstrates tribunals’ willingness to engage in a substantive manner in national environmental law remediation obligations.

11 *Perenco Ecuador Ltd. v. The Republic of Ecuador and Empresa Estatal Petróleos del Ecuador (Petroecuador)*, ICSID Case No. ARB/08/6, pending.

12 *Occidental Petroleum Corp. v. Ecuador*, ICSID No. ARB/06/11, Award, 2012.

13 See OECD/G20, Inclusive Framework on BEPS: Progress Report July 2017–June 2018, 22 July 2018.

2. Case Summary

2.1 Factual Background

Burlington Resources Inc. (Burlington) is a U.S. investor investing in several oil production facilities in Ecuador together with its consortium partner Perenco Ecuador Ltd. (Perenco).¹⁴ Burlington was assigned production-sharing contracts (PSCs) in 2001 for Blocks 7 and 21. The PSCs put the entire cost and operational risk on Burlington and Perenco. In return, they were to receive a share in the oil produced. The PSCs defined the tax regime applicable to Burlington. They also set out an obligation for the state-owned oil company PetroEcuador to absorb any future tax increases by including a correction factor in the production-sharing formula (para. 21, decision on liability).

After a substantial rise in oil prices, Ecuador adopted Law 42 in April 2006. According to the law, a 50 per cent tax was imposed on “extraordinary profits,” also called “windfall profits,” made by oil companies (para. 32, decision on liability). In October 2007 Ecuador raised the tax rate on windfall profits to 99 per cent (para. 35, decision on liability). Windfall profits were defined as the profits resulting from an “unforeseen” rise of oil prices in excess of the price level at the time of conclusion of the PSCs. Burlington paid the tax while at the same time making a request for “absorption” of the additional taxes. Ecuador and PetroEcuador ignored the request, and any attempt to renegotiate the PSCs failed. Burlington paid the tax imposed by Law 42 from 2006 to 2008, but decided to stop paying in 2009. In order to enforce its tax claims, Ecuador seized and auctioned off Burlington’s shares of the oil production. In addition, PetroEcuador acquired oil at below-market prices (paras. 56–62, decision on liability). After Burlington threatened to stop the production, Ecuador took possession of the production facilities in July 2009. Ecuador ultimately annulled the PSCs with Burlington by ministerial decree (paras. 63–66, decision on liability).

2.2 Summary of Legal Issues and Decisions

Burlington made a Request for ICSID Arbitration on April 21, 2008. In its principal claim, Burlington argued that four measures taken by Ecuador—Law 42, the seizure of shares, the physical takeover of the production facilities and the termination of the PSCs—constituted an expropriation. According to Ecuador, its measures were not expropriatory mainly because Burlington had no right to revenues stemming from oil prices in excess of the price assumption made by the parties. In addition, Ecuador filed counterclaims for violations of Ecuadorian environmental laws and breaches of contractual obligations by Burlington.

In its decision on liability, by analyzing each measure individually, the tribunal found that Law 42 was not expropriatory as such, because it did not substantially deprive Burlington of the investment as a whole. The seizure of certain fractions of the investment was also not tantamount to expropriation mainly because the investment remained profitable. However, the tribunal found that Ecuador expropriated Burlington’s investment when it took possession of the production facilities in 2009.

¹⁴ Perenco also filed a claim against Ecuador, see *Perenco Ecuador Ltd. v. The Republic of Ecuador and Empresa Estatal Petróleos del Ecuador (Petroecuador)*, ICSID Case No. ARB/08/6, pending.

On February 7, 2017 the tribunal issued a decision on the counterclaims of Ecuador, ordering Burlington to pay USD 41.7 million to Ecuador for breach of Ecuadorian environmental law and contractual obligations.

Lastly, a decision on “Reconsideration and Award” was also released on February 7, 2017 in which the tribunal dismissed the request made by Ecuador to reconsider the question of liability. It also set the quantum of the award: the Tribunal awarded damages of USD 379.8 million to Burlington for the expropriation of its investment.

3. Select Legal Issues

3.1 The Issue of Taxation and Expropriation

The approach taken by the tribunal gives some insight into how issues of state liability for expropriation can or cannot arise from tax measures. The tribunal adopted an approach in which the effect of the expropriation is more relevant than the intent of the host state.

First, Burlington argued that Law 42 imposing a 50 per cent tax, which applied between April 2006 and October 2007, had a devastating impact on its investment (para. 420, decision on liability). In 2006, its profits diminished by 40 per cent and in 2007 by 62.9 per cent (para. 426, decision on liability). On these figures, the majority of the tribunal held that Burlington did not suffer a substantial deprivation of its investment. It found so based on three elements. First, the consortium submitted plans for further investments in Block 7, thereby implicitly conceding that Block 7 was economically viable with Law 42 at 50 per cent in force. Second, Burlington’s financial statement for Block 21 showed positive figures, not losses. Third, there were bidders willing to acquire Burlington’s interests in Blocks 7 and 21 despite Law 42 being in force. Furthermore, according to the tribunal, the intent of Ecuador in adopting Law 42 was not to force Burlington to abdicate its rights under the PSCs; rather, the intent was to share the windfall profits resulting from higher oil prices on a 50/50 basis between the state and the oil company (para. 432, decision on liability).

Second, Burlington argued that Law 42 imposing a 99 per cent tax destroyed the value of its investment (para. 434, decision on liability). Law 42 at 99 per cent applied from November 2007 to March 2009—thus, it applied throughout 2008. Burlington proved that it did not make profits in 2008. On a diminishment of revenue basis, the impact of Law 42 at 99 per cent meant that Burlington saw its share of oil revenues reduced, 58 per cent regarding Block 7 and 70.2 per cent regarding Block 21 (para. 450, decision on liability). With respect to Law 42 imposing a 99 per cent tax, the tribunal accepted Burlington’s argument that the law was intended to make Burlington abdicate its rights under the PSCs. However, the tribunal held that the intent was less important since “the State’s intent alone cannot make up for the lack of effects amounting to a substantial deprivation” (para. 455, decision on liability).

The dissenting arbitrator, Francisco Orrego Vicuña who was subsequently disqualified on December 13, 2013, did not agree with the majority of the tribunal on the analysis of Law 42. For him, Law 42—whether at 50 per cent or at 99 per cent—was expropriatory. He underlined that the tax prevented Burlington from recovering from past investments, forced it to scale back its development plans and diminished the value of its overall investment. In his opinion, the impact of Law 42 at 50 per cent was “very substantial” and the impact of Law 42 at 99 per cent was “confiscatory” (para. 27, dissent). He pleaded for the adoption of a more flexible approach based on reasonableness, where the reasonableness is measured by asking what a “reasonable businessman” would be likely to conclude after the imposition of Law 42 (paras. 25–26, dissent).

In sum, the majority of the tribunal set a high threshold with respect to expropriation claims based on tax measures, requiring substantial deprivation. However, the tribunal did find that the physical taking of the blocks constituted an unlawful expropriation of Burlington’s investment (para. 545, decision on liability).

It is interesting to note that the *Perenco* tribunal’s analysis was similar. It held that at 50 per cent, the disputed tax measure reduced the investor’s profitability but it did not deprive *Perenco* of its rights of management and control over the investment in Ecuador, nor did it reach the requisite level of a substantial diminution in the value of that investment. In addition, it found that although the tax at 99 per cent rendered the investment operation suboptimal, the tax did not amount to an expropriation because *Perenco*’s business was not effectively taken away from it.¹⁵

3.2. Successful Counterclaims of Ecuador

In the past years, many counterclaims made by the host state have been rejected because tribunals did not accept having jurisdiction over them. In the case of Ecuador’s counterclaims, the tribunal’s jurisdiction was not disputed. In fact, Burlington and Ecuador entered into an agreement in May 2011 in which they explicitly stated their consent to jurisdiction over the counterclaims of Ecuador (paras. 60–62, decision on counterclaims). Thus, the *Burlington* case did not break new ground with respect to jurisdiction over counterclaims due to the very specific agreement in place. The approach taken by the *Burlington* tribunal, however, does break new ground, insofar as it included a detailed analysis of national environmental law as it related to the investment at issue.

Ecuador argued that Burlington’s activities had resulted in significant environmental damage (environmental counterclaim) and amounted to a failure to properly maintain the blocks’ infrastructure in good working condition (infrastructure counterclaim). The environmental counterclaim was divided into four factual settings: soil contamination, mud pits, groundwater and well site abandonment. The counterclaim on infrastructure was divided into five different aspects of the oil exploration and exploitation: tanks, fluid lines and pipelines, generator engines, crude–diesel fuel blend and finally, pumps, electrical system, IT and roads.

¹⁵ *Perenco Ecuador Ltd. v. Ecuador*, No. ARB/08/6, Decision on Liability (ICSID 2014) (*Perenco (Liability)*), paras. 672 and 687.

3.2.1 Applicable Law

The ICSID Convention, the ICSID Arbitral Rules and the tribunal's procedural orders governed the procedure of the counterclaims. With respect to the substance of the counterclaims, a distinction needs to be made between the environmental and the infrastructure counterclaim (paras. 71–75, decision on counterclaims). First, according to Ecuador its environmental counterclaim was based solely on its national tort law and not contract law. Moreover, neither party argued that the choice of Ecuadorian law in the contract between them also encompasses Ecuadorian tort law. Therefore, the tribunal applied Ecuadorian tort law, not as the law chosen by the parties (Article 42(1) of the ICSID Convention) but as the law of the host state (Article 42(2) of the ICSID Convention). Applying the second leg of Article 42 is of relevance because, with respect to the environmental counterclaim, international law may also be applicable. More precisely, it is within the tribunal's discretion to apply either domestic or international law depending on the type of issue to be resolved. Second, as far as the infrastructure counterclaim is concerned, the tribunal decided to apply Ecuadorian law as the law chosen by the parties (Article 42(1) of the ICSID Convention).

3.2.2 Strict Liability for Environmental Harm

The liability regime for hydrocarbons in Ecuador is enshrined in the 2008 Constitution of Ecuador. The Constitution provides for a strict liability for environmental harm (paras. 229–230, decision on counterclaims). However, the 2008 Constitution did not apply in the present case, according to the tribunal, since Burlington started its oil exploitations in Ecuador before 2008 and did not accept that the constitutional regime had retroactive effect (para. 102, decision on counterclaims).

The tribunal held that the regime prior to 2008 was in principle a fault-based liability, which means that operators can escape liability when proving that they acted with due diligence (para. 236, decision on counterclaims). However, as an exception to this general rule, Ecuadorian courts established a strict liability regime for certain activities including oilfield operations. Such a regime based on case law had applied to Burlington at least since 2002 (para. 236, decision on counterclaims). The former strict liability regime under Ecuadorian law foresaw that the plaintiff must prove harm connected to the defendant's activities, the existence of fault is not required, and causation between the harm and the defendant's activity is presumed (para. 238, decision on counterclaims). Consequently, once Ecuador proved environmental harm, Burlington could only escape liability by proving that the harm was caused by force majeure or by a third party.

3.2.3 Reviewing Evidence and the Principle of *in dubio pro natura*

Reviewing the evidence on the existence of environmental harm was the most comprehensive part of the tribunal's analysis. The tribunal did a site visit in March 2015 to gain an impression of the environmental degradation (para. 27, decision on counterclaims). The most complex issue was the assessment of the contamination of the oil sites. The tribunal reviewed each site of Burlington's oil fields and classified them into "industrial," "agricultural" or "sensitive

ecosystem” since for each classification a different standard was applicable. This allowed the tribunal to determine the appropriate remediation costs and consequently the compensation due from Burlington. It is noteworthy that whenever there was doubt on the classification of the sites, the tribunal “adopted the most protective standard in conformity with the principles of precaution and *in dubio pro natura*” (para. 343, decision on counterclaims).

3.2.4 Compensation Was Only a Fraction of the Sum Claimed by Ecuador

The damages that the tribunal awarded pursuant to the counterclaims were only a fraction of the USD 2.8 billion initially claimed by Ecuador. In particular, Ecuador sought compensation of USD 2.5 billion for the remediation costs to restore the oilfields to their original condition and USD 300 million for breaches of Burlington’s obligations to maintain the infrastructure of the oilfields. The tribunal ordered Burlington to pay USD 39.2 million for environmental remediation and a further USD 2.5 million for Burlington’s breaches with respect to the maintenance of the infrastructure. Thus, the final compensation was USD 41.7 million, with post-award interest at the LIBOR¹⁶ three-month rate plus 2 per cent (para. 1099, decision on counterclaims). The important difference between the amount claimed and the final compensation lies within the diverging assessments of the remediation costs provided by the disputing parties. For most of the contaminated oil fields, the tribunal was more convinced by the cost assessment made by Burlington.

16 London Interbank Offered Rate.

Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. The Argentine Republic, ICSID Case No. ARB/07/26 (Urbaser v. Argentina)

Decisions and award are available at <http://www.italaw.com/cases/1144>

Keywords: human rights, international accountability of investors, counterclaim

Key Dates:

Request for Arbitration: July 20, 2007
Constitution of Tribunal: October 16, 2009
Decision on Jurisdiction: December 19, 2012
Award: December 8, 2016

Arbitrators:

Andreas Bucher (president)
Campbell McLachlan (respondent appointee)
Pedro J. Martínez-Fraga (claimant appointee)

Forum and Applicable Procedural Rules:

International Centre for Settlement of Investment Disputes (ICSID)
ICSID Rules of Procedure for Arbitration Proceedings

Applicable Treaty:

Spain–Argentina Bilateral Investment Treaty (BIT)

Alleged Treaty Violations:

- Arbitrary, unreasonable and/or discriminatory measures
- Expropriation
- Fair and equitable treatment

Other Legal Issues Raised:

- Jurisdiction – 18-month litigation provision
- Jurisdiction – most-favoured-nation (MFN) treatment
- Jurisdiction/merits – counterclaim on human rights

1. Importance for Sustainable Development

The *Urbaser v. Argentina* case was rendered while the international accountability of corporations is the subject of intense debates within the international community. Most prominent are the discussions at the United Nations Human Rights Council. An open-ended intergovernmental working group was established in 2014 to work toward a binding treaty for transnational corporations and other business enterprises with respect to human rights. The present award thus feeds into the current discussion on foreign investment and human rights in the context of sustainable development.

The dispute in the Urbaser case arose as a result of the Argentina's financial crisis. Urbaser was a shareholder in a concessionaire that was in charge of the supply of water and sewerage services. Argentina's emergency measures led to financial losses of the concessionaire, resulting into its insolvency. Urbaser initiated arbitral proceedings against Argentina. For its parts, Argentina filed a counterclaim in which it alleged that the concessionaire's failure to provide the necessary level of investment in the supply services led to violations of the human right to water.

The tribunal in the Urbaser case accepted its jurisdiction over the Argentina's counterclaim based on human rights and confirmed that the "right to water" was a human right under international law. It is the first award to provide an in-depth discussion on a state's counterclaim against an investor for an alleged violation of human rights obligations. At the same time, the award does not mark the breakthrough of human rights obligations directly applicable to foreign investors. While the case raises a number of complex issues, some important elements are the following:

First, the acceptance of the counterclaim was based on a broad jurisdictional clause. Other BITs might not allow a respondent state's counterclaim. The award thus highlights that if states wish to insert a possibility for counterclaims in investor-state arbitration, it is important to draft jurisdictional clauses in a clear manner.

Second, it is on the one hand remarkable that the tribunal, by citing international human rights instruments, found that human rights obligations such as the right to water can be imposed directly on international corporations. Yet on the other hand, the award shows that international human rights obligations are primarily addressed to states and are not drafted in a way as to contain binding obligations on corporations. If states wish to impose direct obligations on investors, it is important to do so through explicit language in the BIT. A recent example in this context is the Morocco-Nigeria BIT. In the case of Urbaser, the tribunal could not imply that international human rights instruments would create obligations for the investor.

Third, the Urbaser case also points to the distinction between negative and positive obligations investors. Negative obligations require the investor not to violate human rights, whereas positive obligations require a positive (proactive) action by the investor to ensure that the local population enjoys its human rights. The Urbaser case moves in the direction of a positive obligation for investors to ensure an effective right to water, although in the specific case, the tribunal found that there was no international law basis for the investor's positive obligation on the right to water.

The present summary focuses on the matters of jurisdiction and merits of the counterclaim on human rights.

2. Case Summary

2.1 Factual Background

The dispute arose in the context of a concession for water and sewage services to be provided in the Province of Buenos Aires. The concession was granted to Aguas Del Gran Buenos Aires S.A. (AGBA). The claimants in the present case are shareholders of AGBA, namely Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa.

The emergency measures taken by Argentina in the context of the 2001–2002 economic crisis caused financial losses to the claimants, and the concession was finally running into deadlock. AGBA and its shareholders made numerous requests for a new valuation of its tariffs and for a complete review of the concession. However, the negotiating process did not lead to a successful outcome. In July 2006, the province finally terminated the concession.

2.2 Summary of Legal Issues and Award

At the jurisdictional level, Argentina objected to the jurisdiction of the tribunal because the claimants did not respect the requirement to first resort to Argentinian courts during an 18-month window as required in the Argentina–Spain BIT. The claimants in turn argued that the MFN clause contained in the Argentina–Spain BIT allowed them to circumvent the 18-month domestic litigation requirement because other BITs allowed access to international tribunals without such a requirement. Unlike previous tribunals dealing with this requirement, the tribunal in the present case did not focus its reasoning on the MFN clause and the possibility to import a more favourable procedural requirement for the investor, but instead interpreted the requirement in light of efficiency. It concluded that the 18-month litigation period was inapplicable because the local courts of Argentina were unlikely to be able to render a decision on the merits within this time limit (para. 22, decision on jurisdiction). Both approaches can be problematic from treaty drafters’ perspectives, as they allow tribunals to disregard clearly formulated requirements in the treaty that attempt to safeguard the role of domestic courts, an important part of any country’s legal governance.

On the merits, the claimants argued that the Province of Buenos Aires obstructed AGBA’s operations and was unwilling to renegotiate the concession. According to the claimants, this amounted to a breach of Argentina’s obligations under the Spain–Argentina BIT, namely the prohibition against adopting unjustified or discriminatory measures and the obligations to afford fair and equitable treatment (FET) and not to expropriate unlawfully.

Argentina in turn argued that the Province of Buenos Aires had no alternative but to terminate the concession, given AGBA’s and the claimants’ bad management and failure to fulfill their obligations under the concession. In addition, Argentina argued that the claimants never remedied the deficiencies and that Argentina tried to assist in the negotiations for more than a year, but no compromise could be reached. Interestingly, Argentina also filed a counterclaim for damages on the claimants’ failure to provide the necessary investment into the concession. According to Argentina, the claimants also violated their commitments and obligations under international law based on the human right to water (para. 1165).

The tribunal found that Argentina violated the FET standard during the negotiations period. However, it did not grant damages for the FET breach on the basis that the concession agreement failed predominantly due to the claimants' failure to make the necessary investment. The tribunal dismissed all other claims. With respect to Argentina's counterclaim, it affirmed its jurisdiction to hear it, but ultimately dismissed it on the merits.

3. Select Legal Issues

3.1 Human Rights Counterclaim: Jurisdiction

The tribunal in the present case was the first to entertain a counterclaim based on human rights. It affirmed its jurisdiction for four main reasons.

First, the tribunal looked at the dispute settlement clause in the Spain–Argentina BIT, Article X(1), which states: “[d]isputes arising between a Party and an investor of the other Party in connection with investments within the meaning of this Agreement shall, as far as possible, be settled amicably between the parties to the dispute.” The tribunal held that this provision is completely neutral as to the identity of the claimant or respondent in a dispute arising between the parties (para. 1143). It also considered that, as both parties are entitled to lodge a claim, it would be unfair that the one acting first could prevent the other from raising a claim (para. 1144).

Second, the tribunal rejected the claimants' arguments that they would have never consented to the possibility of counterclaims. On the contrary, the tribunal found that the consent given by the claimants on the basis of Article X of the BIT, which they invoked, covers any disputes in connection with the investment and is therefore not restricted to the claims of the claimants.

Third, the tribunal found that the counterclaim was filed in time even though this occurred many years after the claimants had given notice of the dispute to the respondent. It indicated that, according to Rule 40(2) of the ICSID Rules of Arbitration, applicable here, a counterclaim must be submitted no later than the counter-memorial (para. 1150), and that Argentina respected this condition.

Fourth, the tribunal found that there was a direct connection between the claimants' claim under the BIT and the counterclaim. The tribunal examined this question as a matter of jurisdiction. On the one hand, the tribunal held that “the factual link between the two claims is manifest” (para. 1151) as both claims concerned the same investment or the alleged lack of sufficient investment in relation to the same concession. On the other hand, the tribunal stressed the legal link between the two claims. In the present case, Argentina's counterclaim was not based solely on domestic law. Argentina argued that the claimants' failure to provide the necessary investment caused a violation of the fundamental right for access of water, “which was the very purpose of the investment agreed upon in the Regulatory Framework and the Concession Contract and embodied in the protection scheme of the BIT” (para. 1151).

For all these reasons, the tribunal concluded that it had jurisdiction on the basis of ICSID Convention Articles 25 and 46 and BIT Article X.

3.2 Human Rights Counterclaim: Merits

The analysis of the tribunal is divided into three parts: the applicable law, the BIT's relation to international law and human rights, and the human right to water in the framework of AGBA's concession.

With respect to the applicable law, the tribunal held that it would be wrong to categorically understand BITs as not providing any rights to the host state and not imposing any obligations upon investors (paras. 1182–1183).

In the eyes of the tribunal, the applicable BIT was not an isolated or closed system, since the BIT itself allows reference to other sources of international law. The tribunal came to this conclusion by looking at three provisions of the BIT: the dispute settlement clauses, the applicable law clause and the MFN clause titled “more favourable terms.” It noted that the applicable law clause was particularly interesting as it refers to “general principles of international law.” The tribunal found that this reference would be meaningless if the BIT were construed in isolation of the rest of international law. Interpreting the BIT in such a way would even be wrong, according to the tribunal, since the interpretation of a treaty must give *effet utile* to its provisions. Thus, the tribunal found that the BIT cannot be construed as an isolated set of rules of international law for “the sole purpose of protecting investments through rights exclusively granted to investors” (para. 1189).

The tribunal then turned to the question of the BIT's relation with international human rights law. Here, it rejected the claimants' argument that corporations could not by nature be subjects of international law in a state-to-state system and stated that, “[w]hile such principle had its importance in the past, it has lost its impact and relevance in similar terms and conditions as this applies to individuals” (para. 1194). Interestingly, the tribunal also held that, even if a BIT does not contemplate investors as subjects of international law, this would not undermine the idea that foreign investors could be subjected to international law obligations (para. 1194). Moreover, the tribunal stressed that, in the light of recent developments in international law, it could no longer be admitted that companies operating internationally would be immune from becoming subjects of international law (para. 1195).

To determine whether there are international law obligations attached to non-state entities, the tribunal held that the focus must be on contextualizing the “corporation's specific activities as they relate to the human right at issue” (para. 1195). In doing so, the tribunal looked at international conventions and referred to the Universal Declaration on Human Rights (UDHR), the International Covenant on Economic, Social and Cultural Rights (ICESCR) and the International Labour Organization Declaration of Principles concerning Multinational Enterprises and Social Policy. These instruments enounce human rights that are or can be associated with the right to water (paras. 1196–1197).

The tribunal found in particular that article 30 of the UDHR and Article 5(1) of the ICESCR are relevant in the present context (paras. 1196–1197). These articles read as follows:

Article 30 UDHR

“Nothing in this Declaration may be interpreted as implying for any State, group or person any right to engage in any activity or to perform any act aimed at the destruction of any of the rights and freedoms set forth herein.”

Article 5 (1) ICESCR

“Nothing in the present Covenant may be interpreted as implying for any State, group or person any right to engage in any activity or to perform any act aimed at the destruction of any of the rights or freedoms recognized herein, or at their limitation to a greater extent than is provided for in the present Covenant.”

The tribunal stressed that it was undisputed that the right to water and sanitation is recognized as part of human rights and that this right has as its corresponding obligation the duty of states to provide all persons living under their jurisdiction with safe and clean drinking water and sewage services (para. 1205). Despite this finding, the tribunal’s remaining challenge was to construe a legal obligation on the investor (para. 1206), but it could find no such obligation.

According to the tribunal, Argentina’s argument conflated the concessionaire’s provision of water and sewerage with the obligation to fulfill the human right to water, and this meant that the source of the human right in question was not the BIT or international law but the concession contract (para. 1206).

The tribunal stated that, “[f]or such an obligation to exist and to become relevant in the framework of this BIT, it should either be part of another treaty or it should present a general principle of international law” (para. 1207). The tribunal also found that the situation would be different if a negative obligation was at stake (for example, an obligation to abstain, such as the prohibition to commit acts that violate human rights). Of particular interest is that the tribunal stated that such a negative obligation “can be of immediate application, not only upon States, but equally to individuals and other private parties” (para. 1210).

Finally, the tribunal examined the human right to water in the framework of AGBA’s concession. It agreed with Argentina that the concession was designed as a substantial contribution to the enforcement of the population’s right to water. Even so, it found no such corresponding obligation exists under international law (para. 1212). The main responsibility was on the state to exercise its authority over the concessionaire so as to ensure and preserve the population’s basic right to water and sanitation.

Churchill Mining PLC and Planet Mining Pty Ltd v. Republic of Indonesia, ICSID Case No. ARB/12/14 and ICSID Case No. ARB/12/40 (Churchill Mining v. Indonesia)

Award is available at <https://www.italaw.com/sites/default/files/case-documents/italaw7893.pdf>

Keywords: forgery (forged documents), investor due diligence, coal mining

Key Dates:

Request for arbitration: May 22, 2012 (based on United Kingdom–Indonesia BIT),
November 26, 2012 (based on Australia–Indonesia BIT)
Constitution of tribunal: January 22, 2013
Decision on jurisdiction: February 24, 2014
Award: December 6, 2016
Application for annulment: March 31, 2017
Annulment decision: Pending

Arbitrators:

Gabrielle Kaufmann-Kohler (president)
Michael Hwang (respondent's appointee)
Albert Jan van den Berg (claimant's appointee)

Forum and Applicable Procedural Rules:

International Centre for Settlement of Investment Disputes (ICSID)
ICSID Rules of Procedure for Arbitration Proceedings

Applicable Treaty:

United Kingdom–Indonesia BIT and Australia–Indonesia BIT

Alleged Treaty Violations:

- Expropriation
- Fair and equitable treatment

Other Legal Issues Raised:

- Admissibility
- Cost allocation
- Due diligence of investors
- Legal consequences of forgery

1. Importance for Sustainable Development

Responsible behaviour of an investor investing abroad is crucial for ensuring that investment is sustainable. The case of *Churchill Mining v. Indonesia* raised the question of whether an investor can be denied access to investment arbitration based on its failure to comply with the due diligence requirement in relation to business relations with local partners. The tribunal found that the claims were effectively “based on documents forged to implement a fraud aimed at obtaining mining rights” and that, as a consequence, all the claims were inadmissible.

The tribunal noted that neither the ICSID Convention nor the applicable BITs contained language on the consequences of unlawful conduct by a claimant or its business associates. Based on previous jurisprudence, it nevertheless found that general principles can “exist independently of specific language to this effect in the Treaty,” and concluded that claims arising from rights based on fraud or forgery are inadmissible as a “matter of international public policy.”

The case shows that under international investment law, investors can be held accountable for their own behaviour and that of their associates. It also indicates that some tribunals might in some instances find the basis for accountability outside the applicable text. At the same time, the reasoning of the tribunal shows that if state parties want to ensure responsible investor behaviour, it will be best to make this clear in the treaty text itself—this is what tribunals look at first. Also, the tribunal categorized investor fraud as a matter of public order, insofar as the claim arises from “rights based on fraud and forgery.” This means that there will be a consequence if the right itself is tainted by fraud (here the mining licence), but fraud committed during the operation of the investment would likely have a different, or no consequence in an arbitral proceeding, leaving irresponsible behaviour without consequence.

2. Case Summary

2.1 Factual Background

Churchill Mining PLC (Churchill), a British company, and Planet Mining Pty Ltd. (Planet), an Australian company, provide mining services, including general survey services, exploration and exploitation of mining sites and invested in Indonesia. Their investment—the East Kutai Coal Project (EKCP), located in the Regency of East Kutai on the island of Kalimantan in Indonesia—is a mining project that has been developed by the claimants jointly with Indonesian companies. The area of EKCP hosts one of the largest coal deposits on the planet.

In 2010, upon the recommendation of the Indonesian Ministry of Forestry, the Regent of East Kutai revoked the licences related to the EKCP because the licence was allegedly forged (paras. 35-36, decision on jurisdiction). The claimants (as well as the other Indonesian companies) engaged in legal proceeding before domestic courts against the revocation decrees. The claimants alleged that they obtained the licenses lawfully through their partnership with a local group of companies, the Ridlatama companies, and therefore considered the revocations illegal.

2.2 Summary of Legal Issues and Award

Both Churchill and Planet filed requests for ICSID arbitration, based respectively on the United Kingdom–Indonesia and the Australia–Indonesia BIT. The two cases were consolidated and, in its decision of February 24, 2014, the tribunal found that it had jurisdiction.

In the course of the arbitration, Indonesia disputed the validity of the mining licences at issue. In particular, Indonesia raised allegations of forgery, and argued, among other things, that some of the licenses on which the claimants relied were forged by the claimants themselves and by the claimants' Indonesian partner, the Ridlatama companies. The claimants, on the other hand, alleged that they had acted in good faith.

In its final award, the tribunal determined that the claims were effectively “based on documents forged to implement a fraud aimed at obtaining mining rights” and that all the claims were inadmissible (para. 528, award). While unable to definitely identify the source of the forgeries, the tribunal indicated that the local business partner of the claimants was likely the source of the fraudulent conduct but that the claimants failed to exercise sufficient due diligence in carrying out their investment. The tribunal ordered the claimants to pay costs and arbitration fees of nearly USD 9.5 million. In March 2017, they submitted an application for annulment at ICSID.

3. Select Legal Issues

3.1 The Establishment and Assessment of Evidence

In cases of alleged illegal investments due to fraud, corruption or, as in this case, forgery, it is not always easy to establish sufficient evidence. In the present case, Indonesia alleged that 34 licence documents were forged given that the signatures in those documents were not authentic and not authorized. The tribunal found that it was not for the claimants to provide evidence but for the respondent to bear the burden of proof (para. 238). This meant that Indonesia had to provide sufficient evidence in order to sustain its allegations. The tribunal added that the evidence provided by Indonesia was to be measured on a “standard of balance of probabilities or *intime conviction*” that takes into account that more persuasive evidence is required for implausible facts. Moreover, the tribunal held that “intent or motive need not be shown for a finding of forgery or fraud but may form part of the relevant circumstantial evidence” (para. 244).

Based on the evidence provided by Indonesia, the tribunal made the following assessment. First, as all the signatures in the disputed documents had been mechanically reproduced, Indonesia showed that government officials typically sign important documents such as the ones related to mining licences by hand. Second, certain similar documents existed in more than one version; others did not contain signatures or initials of officials and still others out of the 34 documents were not registered in the Indonesian governmental database. Third, there was no evidence for any official licence application with respect to the EKCP made by the Ridlatama companies. Fourth, the tribunal found it particularly odd that 10 days after the

Regent of East Kutai had revoked the licences of the Ridlatama companies a supposed Re-Enactment Degree was issued to declare the licences valid again (para. 441).

Based on all these elements, the tribunal “found that a fraudulent scheme permeated the Claimants’ investments in the EKCP” (para. 507). It acknowledged that the evidence pointed “towards Ridlatama rather than the Claimants in relation to the forgery of the contentious documents,” but found that this assumption was not decisive to draw the proper legal consequences in the present case (para. 476).

3.2 Principles of International Law on the Legal Consequences of Forgery

As the tribunal indicated, neither the ICSID Convention nor BITs, in general, contain substantive provisions on the consequences of unlawful conduct by a claimant or its business associates during the life of an investment (para. 488). However, arbitral jurisprudence at numerous occasions has already had to deal with the impact of the illegality of an investment on its protection under international investment treaties and in investor–state arbitration. And as had been set out in the *Metal-Tech v. Uzbekistan* award, there are general principles “that exist independently of specific language to this effect in the Treaty” (para. 490).

Looking at arbitral jurisprudence, the tribunal found that, depending on the facts of a case, tribunals found that illegality can affect a tribunal’s jurisdiction¹⁷ or the admissibility of the claim,¹⁸ or can be addressed in the merits¹⁹ (para. 494). In any set of circumstances, fraudulent behaviour constitutes an abuse of right, which is contrary to the principle of good faith. In particularly serious cases of fraud, such as was the case in *World Duty Free v. Kenya* and *Metal-Tech v. Uzbekistan*, tribunals found that the investors’ conduct was contrary to international public policy.

Based on the facts of the case, the tribunal concluded that a “fraudulent scheme permeated the Claimant’s investments in the EKCP” (para. 507) and added that claims arising from rights based on fraud or forgery are inadmissible as a “matter of international public policy” (para. 508).

17 See for instance *Phoenix Action, Ltd. v. The Czech Republic*, ICSID Case No. ARB/06/5. Retrieved from <https://www.italaw.com/cases/850>.

18 See for instance *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24. Retrieved from <https://www.italaw.com/cases/857>.

19 See for instance *David Minnotte & Robert Lewis v. Republic of Poland*, ICSID Case No. ARB (AF)/10/1. Retrieved from <https://www.italaw.com/cases/707>.

3.3 The Required Level of Due Diligence of the Investor

As the tribunal found that the author of the forgeries were not directly the claimants but their Indonesian business partner, the Ridlatama companies, the question arose whether the claimants adopted an adequate level of due diligence when investing in the EKCP. The tribunal relied in particular on the reasoning of the *Minnotte v. Poland* case, in which the tribunal contemplated the possibility that a claim may be vitiated where the claimant unreasonably failed to perceive evidence of serious misconduct or crime by a third party (para. 502). According to the Churchill and Planet tribunal, the *Minnotte* case concerns the so-called “head-in-the-sand problem,” where a claimant knew or should have known of third-party wrongdoing in connection with an investment and still chose to do nothing (as opposed to just failing to take due care) (para. 504). This standard is also referred to as “conscious disregard” or “willful blindness.” The tribunal added that in particular when investors invest in a risky business environment, they are expected to exercise due diligence before committing any funds (para. 506).

In the present case, the tribunal held that the claimants did not act with due diligence but rather in a negligent way when they inquired into the processes through which their Indonesian partners had secured the mining licences (paras. 517–527). Such a lack of diligence, in relying on fraudulent acts by a third party barred the protection of the applicable BITs. Thus the “willful blindness” of the claimants was such as to make their claims inadmissible.

Pac Rim Cayman LLC v. Republic of El Salvador, ICSID Case No. ARB/09/12 (Pac Rim v. El Salvador)

Decisions and Award are available at <https://www.italaw.com/cases/783>

Keywords: mining, national investment law

Key Dates:

Request for Arbitration: April 30, 2009

Constitution of Tribunal: November 18, 2009

Decision on the Respondent's Jurisdictional Objection: June 1, 2012

Award: October 14, 2016

Decision on the Respondent's Request for a Supplementary Decision: March 28, 2017

Arbitrators:

V. V. Veeder (president)

Brigitte Stern (respondent appointee)

Guido Santiago Tawil (claimant appointee)

Forum and Applicable Procedural Rules:

International Centre for Settlement of Investment Disputes (ICSID)

ICSID Rules of Procedure for Arbitration Proceedings

Applicable Treaty:

Dominican Republic–Central America–United States Free Trade Agreement (CAFTA),
Investment Law of El Salvador

Alleged Treaty Violations:

- Expropriation
- Prohibition of arbitrary and discriminatory measures
- Right to appropriate treatment
- Right to efficient legal procedures
- Right to protection of property

Other Legal Issues Raised:

- Amicus Curiae
- Denial of Benefits clause

1. Importance for Sustainable Development

The *Pac Rim* case attracted much attention from the media because several civil society groups organized opposition against the mining company. The government of El Salvador had refused to grant a mining concession in response to strong public concerns that the mine could contaminate a major source of drinking water. The case fed into the general controversy of states' right to regulate, and specifically the right to regulate of smaller and economically weaker states that possess important natural resources, as is the case of El Salvador.

An amicus curiae submission by the Center for International Environmental Law (CIEL), six local communities and other organizations supported El Salvador's decision to deny the mining concession. It underlined the human right to a healthy environment and stressed the potential risks of the investment activities for the local population and the environment. It also pointed to the importance of community participation in the context of investment activities relating to the exploitation of natural resources, indicating that the state's permanent sovereignty over its natural resources finds both its legitimacy and its limits in the public interest. Moreover, it indicated that community participation is a crucial element of sustainable development and part of international environmental law,²⁰ expressing the right of people to participate in decisions that affect them.

The amicus brief sought to bring the local community perspective into the arbitration process to sensitize the tribunal to the social and environmental risks related to the investment. Unfortunately, the *Pac Rim* tribunal did not elaborate on the issue of community participation. It found that the disputing parties did not consent to disclose important evidence of the arbitration to CIEL and that, in order for it to decide the case, it was not necessary to specifically consider the arguments advanced by CIEL. Consequently, the tribunal refused to address the amicus brief.

Effective participation in the proceedings also includes access to all relevant documents, which can, however, be barred by the disputing parties that refuse to grant access. Accordingly, the *Pac Rim* case demonstrates the difficulties that civil society and others face in having their voices heard in international arbitration proceedings.

Pac Rim brought the case under the CAFTA's investment chapter as well as under El Salvador's investment law. The tribunal declined jurisdiction based on CAFTA but accepted jurisdiction under El Salvador's investor-state dispute settlement (ISDS) clause in its investment law. Therefore, when assessing the legality of El Salvador's measure, it did not apply the same standards typically included in investment treaties, but instead applied the principle of proportionality (enshrined in the country's constitution) to the examination of the requirements under El Salvador's mining law. If the CAFTA had been applicable, one might question whether the tribunal would have arrived at the same decision on the merits by applying treaty standards such as fair and equitable treatment (FET).

20 See United Nations, Economic Commission for Latin America and the Caribbean (ECLAC), Regional Agreement on Access to Information, Public Participation, and Justice in Latin America and the Caribbean, adopted 4 March 2018.

Finally, it is interesting to highlight that all three ISDS cases initiated against El Salvador so far have been based on the country's national investment law. The *Pac Rim* case thus also shows that such investment laws enhance the risks of countries being sued in case the applicable legislation contains advance consent to ISDS.

2. Case Summary

2.1 Factual Background

Pac Rim Cayman LLC (later acquired by Oceana Gold) was a Canadian gold miner investing in El Salvador at a time when the country was promoting foreign investments to develop its mining industry and boost its economy. Between 2002 and 2008 Pac Rim acquired mining licences to conduct exploratory and pre-mining activities in various concession areas. It discovered high-grade gold reserves in the El Dorado project situated in Cabañas. Hence, Pac Rim's subsidiary Pac Rim El Salvador (PRES) applied for the necessary exploitation concessions in 2004 (para. 6.13, award).

Pac Rim's largest activity was the El Dorado project. However, El Salvador refused to issue the concession since Pac Rim failed to comply with the requirements under El Salvador's mining law. Namely, it failed to submit an environmental permit and acquire the consent of the landowners of property situated in the concession area in question.

In 2005, Salvadoran authorities discussed amendments to the mining law. The amendments would limit the documents required for obtaining mining concessions. Pac Rim was collaborating with the competent ministry on the potential amendments and therefore optimistic of ultimately obtaining the concession (para. 6.64, award). However, the El Salvador legislature rejected the amendments in 2008 (para. 6.124, award). Also, Pac Rim at that point had yet to submit the missing documents required to comply with the application requirements. In March 2008, it was reported that the president of El Salvador stated that "in principle" he was against the granting of permits for new mining exploitations and was asking the parliament to review the issue in depth (para. 6.125, award). One year later, the president specifically stated that he would grant no mining concession to Pac Rim (para. 6.129, award), which finally dashed the expectations of the claimant to obtain the concession.

2.2 Summary of Legal Issues and Award

In April 2009, Pac Rim initiated international arbitration under the CAFTA and El Salvador's Investment Law. It argued that the denial of the El Dorado concession resulted from a de facto ban on metallic mining, and that this ban by El Salvador was in breach of the country's obligations under Salvadoran and international law. Pac Rim asked for compensation of more than USD 314 million. El Salvador countered that Pac Rim's project simply did not meet the requirements with respect to several material aspects and that therefore no damages should be granted.

In the 2012 Decision on the Respondent’s Jurisdictional Objection, the tribunal declined its jurisdiction over the claims based on CAFTA. However, the tribunal agreed to hear the claims based on El Salvador’s investment law. In its final award, the tribunal rejected all of Pac Rim’s claims against El Salvador. The tribunal awarded USD 8 million to El Salvador to cover a portion of its arbitration costs, which totalled USD 12 million. In 2017, the tribunal also granted El Salvador post-award interest.

3. Select Legal Issues

3.1 The Denial of Benefits Clause in CAFTA

The *Pac Rim* tribunal was the first to interpret the denial of benefits clause contained in CAFTA. Pac Rim argued that it was protected under CAFTA due to its incorporation in the U.S. state of Nevada. The CAFTA provision (Article 10.12.2) permits a CAFTA state party to deny the benefits of treaty protection, including access to ICSID arbitration, to an investor if two cumulative conditions are met. First, the investor has “no substantial business activities in the territory of any Party.” Second, persons of a non-Party to CAFTA own or control the enterprise that is making the investment.

Like the majority of international investment agreements, CAFTA does not define the notion of “substantial business activity.” Therefore, the tribunal had to assess the factual circumstances of the case. Based on the evidence presented to it, the tribunal concluded that Pac Rim did not have substantial business activities in the United States and was “a passive actor” there (para. 4.68, decision on jurisdiction). The tribunal added that traditional holding companies might still meet the conditions set out in CAFTA. However, in this case, the particularly tenuous scale of Pac Rim’s activities justified the tribunal’s conclusion that it was “more akin to a shell company with no geographical location for its nominal, passive, limited and insubstantial activities” (para. 4.75, decision on jurisdiction).

As to the second condition set out above, the tribunal accepted El Salvador’s argumentation and found that Pac Rim was owned by Pacific Rim Mining Corporation, which in turn is a Canadian entity. According to the tribunal, the fact that the ultimate owners or controllers of Pac Rim had postal addresses in the United States was insufficient for them to qualify as U.S. nationals under CAFTA (see Annex 2.1, CAFTA). CAFTA provides that for the United States, natural persons mean U.S. nationals, that is, American citizens or persons who owe permanent allegiance to the United States of America, as per the requirements of the U.S. Immigration and Nationality Act (para. 4.81, decision on jurisdiction). Consequently, the tribunal declined to exercise jurisdiction over Pac Rim’s CAFTA claims. However, it upheld its jurisdiction based on El Salvador’s investment law (para. 5.48, decision on jurisdiction).

3.2 Interpretation of Article 37(2)(b) of the Mining Law

The central question of the case was whether Pac Rim was actually entitled to the El Dorado concession. In determining whether this was the case, the tribunal focused on the legal interpretation of El Salvador's mining law and not on the state's investment law. Article 37(2) (b) requires that the applicant for an exploitation concession submit "the property title for the real estate or authorized permissions, in legal form, from the landowner." Pac Rim understood this provision to merely require documentation for the area (likely) to be *directly affected*, while El Salvador interpreted it as requiring documentation for the *entire* surface area of the requested concession.

The tribunal rejected Pac Rim's interpretation and relied on three specific factors. First, it found that Pac Rim knew very well that the state's interpretation was not the same as Pac Rim's own understanding of the law. In fact, it considered that instead of elaborating an alternative plan, Pac Rim relied on a prospective amendment of the legislation, which turned out to be a mistake (para. 8.30, award). Second, the tribunal underlined that as a general approach "deference should be given by an international tribunal to the unanimous interpretation of its own laws given in good faith by the responsible authorities of a State at a time before the emergence of the parties' dispute" (para. 8.31, award). Thus, in the present case, the tribunal found that there was no reason to prefer Pac Rim's "non-authoritative" interpretation over El Salvador's. Third, the tribunal approached the provision in question through a teleological interpretation. According to the tribunal, the law would not fulfill its purpose if only applied to surface installations. What mattered were instead the potential risks posed to landowners and occupiers of the area. In order to sustain this assumption, the tribunal referred to the principle of proportionality under Salvadoran constitutional law and held that there is a rational relationship between the means and ends of the requirement in light of the interpretation given by El Salvador. In other words, potential risks are sufficient in order to require consent from surface owners and occupiers.

In conclusion, the tribunal held that Pac Rim had never complied with the requirements for its exploitation concession to be granted and that El Salvador had committed no breach in failing to grant it (para. 8.44, award).

3.3 The Issue of Estoppel or *actos propios*

Pac Rim submitted an alternative argument of estoppel, claiming that El Salvador made a clear statement that Article 37(2)(b) of the mining law would not result in a refusal to grant the concession. The tribunal found that the application of the principle of estoppel, both under international and Salvadoran law, required an "unequivocal statement by the Respondent," and reliance on this by the investor (para. 7.53, award). However, it found no evidence that El Salvador had made any statement that the concession application would be approved regardless of the investor's compliance with the mining law. Especially, it clarified that there could be no representation from the executive that the legislature would amend the law, since this representation would be unlawful under Salvadoran law. Thus, the tribunal rejected this claim.

3.4 The Amicus Curiae Submission of the Center for International Environmental Law (CIEL) and Others

CIEL and others filed an application as a non-disputing party pursuant to the ICSID Convention. In its amicus curiae brief, CIEL argued that El Salvador's measures regarding Pac Rim's mining project find support in the country's international obligations on human rights and environmental protection. In particular, human rights obligations relating to the environment require that El Salvador put in place a legal framework to ensure the full enjoyment of fundamental rights of its communities that are threatened by hazardous activities of third parties. CIEL also underlined that the national legislation was aimed at implementing the rights of access to information, participation and justice in environmental matters, enshrined in Principle 10 of the Rio Declaration on Environment and Development, requiring in the present case the dialogue between mining operators and local communities.

Unfortunately, the tribunal declined to consider CIEL's case. It did so for two reasons. First, the tribunal emphasized that the disputing parties did not consent to disclose factual evidence of the arbitration to CIEL. Second, it found that in order to decide the case, it was not necessary to specifically consider the arguments advanced by CIEL. According to the tribunal, it would be "inappropriate" for it to do so in such circumstances (para. 3.30, award).

Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay, ICSID Case No. ARB/10/7

Decision and award available at <http://www.italaw.com/cases/460>

Keywords: expropriation – police power doctrine, fair and equitable treatment –
margin of appreciation, legitimate expectations

Key Dates:

Request for arbitration: February 19, 2010

Decision on jurisdiction: July 2, 2013

Award: July 8, 2016

Decision on the rectification of the award: September 26, 2016

Arbitrators:

Piero Bernardini (president)

James Crawford (respondent appointee)

Gary Born (claimant appointee)

Forum and Applicable Procedural Rules:

International Centre for Settlement of Investment Disputes (ICSID)

ICSID Rules of Procedure for Arbitration Proceedings

Applicable Treaty:

Switzerland–Uruguay Bilateral Investment Treaty (BIT)

Alleged Treaty Violations:

- Denial of Justice
- Expropriation
- Fair and equitable treatment
- Umbrella clause
- Use and enjoyment of investments

Other Legal Issues Raised:

- Jurisdiction—definition of “investment”

1. Importance for Sustainable Development

Philip Morris v. Uruguay and *Philip Morris v. Australia* are among the prime examples of cases (together with the *Vattenfall v. Germany* case) that provoked significant public awareness of the critical implications of investor–state dispute settlement and investment treaties. The reason is that these are cases where an investor challenged a good-faith regulation that seeks to mitigate undisputed public health risks linked to tobacco consumption.

The *Philip Morris v. Australia* case was not examined on the merits. The tribunal found that the claims by Philip Morris were inadmissible because the initiation of the arbitration constituted an abuse of rights, as the corporate restructuring by which Philip Morris acquired its investment in Australia occurred when there was already a reasonable prospect that the dispute would materialize. Therefore, according to the tribunal, the restructuring was carried out for the sole purpose of gaining treaty protection. As such, the tribunal declined to exercise jurisdiction (award on jurisdiction and admissibility, December 17, 2015).²¹ In *Philip Morris v. Uruguay*, the tribunal did uphold its jurisdiction and went further to examine the case on the merits, as discussed below.

From the viewpoint of sustainable development, the *Philip Morris v. Uruguay award* is highly welcome, as it recognized the right to regulate and a wide margin of appreciation for states in adopting measures concerning public health. The tribunal affirmed the police power doctrine and set out that a state does not need to prove a direct causal link between the measure and any observed public health outcomes. It stressed that it is sufficient that measures reflect a reasonable attempt to address a public health concern and are taken in good faith. At the same time, it is not clear whether the same approach would be taken with respect to other areas of public health or environmental protection, where the scientific evidence and consensus are not as clear and where no international legal frameworks like the World Health Organization’s (WHO) Framework Convention on Tobacco Control (FCTC) exist. Would a tribunal apply a similarly wide margin of appreciation?

2. Case Summary

2.1 Factual Background

Uruguay has one of Latin America’s highest smoking rates. Tobacco consumption in Uruguay has massive health implications for its population and affects the Uruguayan economy considerably. Against this background, Uruguay has engaged in important anti-smoking policy measures and adopted two principal regulations.

21 *Philip Morris v. Australia*, PCA Case No. 2012-12, Award on Jurisdiction and Admissibility, 17 December 2015, https://www.italaw.com/sites/default/files/case-documents/italaw7303_0.pdf.

The first was the 2008 Single Presentation Requirement regulation. This instrument provides that tobacco manufacturers could no longer sell multiple varieties of their brand. It also required health warnings to be printed on 50 per cent of the area of cigarette packages. The second measure concerned the so-called “80/80 Regulation.” Under a 2009 presidential decree, the health warnings were to cover 80 per cent, instead of 50 per cent, of the packaging. This meant that only 20 per cent was left for the tobacco companies’ trademarks and other information.

Abal Hermanos S.A. is a Uruguayan company that is fully owned by Philip Morris Brands Sàrl, which is in turn a company registered in Switzerland. Philip Morris Products S.A., also incorporated in Switzerland, owns the relevant trademarks such as *Marlboro*, *Fiesta*, *L&M* and *Philip Morris*, which it licensed to Abal. Abal’s main activity has been the importation of cigarettes for sale in Uruguay.

2.2 Summary of Legal Issues and Award

Abal Hermanos S.A., Philip Morris Brands Sàrl and Philip Morris Products S.A. (hereafter: Philip Morris) initiated arbitration against Uruguay for breach of its obligations under its bilateral investment treaty (BIT) with Switzerland. In particular, Philip Morris targeted the two legislative measures mentioned above. First, the claimant alleged that the Single Presentation Requirement substantially affected the company’s value since it had to pull out 7 of its 13 product variants (paras. 10 and 274). Second, it argued that the 80/80 Regulation wrongfully limited Philip Morris’ right to use its legally protected trademark by infringing on its intellectual property rights and thus further reduced the value of its investment (para. 11).

In a majority decision, the tribunal dismissed all the claims made by Philip Morris and upheld the legality of the two tobacco control measures enacted by Uruguay for the purpose of protecting public health. The tribunal ordered Philip Morris to bear all arbitral costs and to pay Uruguay USD 7 million as partial reimbursement of the country’s legal expenses.

Claimant-appointed arbitrator Gary Born issued a dissenting opinion. He disagreed with the majority in its assessment of the Single Presentation Requirement, arguing that the requirement was not required or contemplated by the WHO FCTC. Furthermore, based on the factual background and evidentiary record in Uruguay, he considered that the Single Presentation Requirement was manifestly arbitrary and disproportionate and constituted a breach of fair and equitable treatment.

3. Select Legal Issues

3.1 Support From the “International Public Health Community” and the Role of the Framework Convention on Tobacco Control

The participation of the WHO, the Pan American Health Organization (PAHO) and the FCTC Secretariat by submitting amicus briefs in these proceedings is interesting to highlight, since the evidence provided by these entities was crucial for the tribunal’s assessment on the effectiveness and reasonableness of the disputed measures. As the WHO and FCTC Secretariat noted, large graphic health warnings are an effective means of informing consumers of the risks of tobacco consumption and of discouraging tobacco consumption. Therefore, the submissions supported that the Uruguayan measures are effective means of protecting public health (para. 38). The PAHO amicus brief stated that “Uruguay’s tobacco control measures are a reasonable and responsible response to the deceptive advertising, marketing and promotion strategies employed by the tobacco industry, they are evidence based, and they have proven effective in reducing tobacco consumption” (para. 43).

The award underscored the importance of the WHO FCTC in setting tobacco control objectives and establishing the evidence base for measures. It suggests that where evidence has been established internationally, states do not need to establish evidence at the domestic level. In light of sustainable development goals, the important weight that the tribunal gave to international health standards shows how and to what extent investment tribunals can take a more systemic integration approach toward different branches of international law.

3.2 Indirect Expropriation: Affirmation of the *police power doctrine*

Philip Morris argued that the Single Presentation Requirement and the 80/80 Regulation constituted an indirect expropriation of its brand assets, including intellectual property and goodwill associated with each of its brand variants (para. 180). According to Uruguay, the measures could not constitute an expropriation mostly because they were a legitimate exercise of its sovereign police power to protect public health (para. 181).

The tribunal by unanimity agreed with Uruguay’s argument. Firstly, it confirmed that the measure did not have the effect of substantial deprivation of the investment since Philip Morris was able to continue its business of selling tobacco products in Uruguay. The tribunal could have stopped there, but considered it relevant to discuss Uruguay’s police powers to further support its finding that there was no expropriation (para. 287).

In the tribunal’s view, Uruguay’s adoption of the challenged measures was a valid exercise of the state’s police powers (para. 287). The award makes it very clear that public health policy relates to heightened public welfare concerns. As such, it stated that protecting public health has long been recognized as an essential manifestation of the state’s police powers (para. 291). The tribunal concluded that the Single Presentation Requirement and the 80/80 Regulation have been adopted in fulfillment of Uruguay’s national and international legal obligations for the protection of public health (para. 302). The measures also satisfied the conditions of the police power doctrine as they were adopted in good faith and for the purpose of protecting public health and were non-discriminatory and proportionate (para. 305).

Interestingly, the expropriation provision contained in the Switzerland–Uruguay BIT does not include a reference to the police power of states. However, the tribunal considered that the provision must be interpreted in accordance with Article 31(3)(c) of the Vienna Convention on the Law of Treaties (VCLT), which requires that the provision must be interpreted in light of “[a]ny relevant rule of international law applicable to the relations between the parties.” This directed the tribunal to customary international law, which includes, according to the tribunal, the police power of states.

3.3 Fair and Equitable Treatment: Wide margin of appreciation for the national legislator and the question of “reasonableness”

Philip Morris further claimed that the measures were arbitrary, since they failed to serve a public purpose but caused substantial harm, and thus breached the fair and equitable treatment (FET) standard. Uruguay counter-argued the claim by stressing once more that the measures were adopted in good faith and in a non-discriminatory manner and that they were logically connected with the state’s public health objectives (para. 310).

The majority of the tribunal dismissed Philip Morris’s arguments. In its analysis, the tribunal made reference to the margin of appreciation as developed in the jurisprudence of the European Court of Human Rights. In particular, the tribunal held that the responsibility for public health measure rests with the government and that investment tribunals should pay great deference to governmental judgments for national needs in matters such as the protection of public health (para. 399). Referring to the *Glamis Gold v. United States* award,²² the tribunal held that the sole inquiry for the tribunal is whether or not there was a manifest lack of reasons for the legislation (para. 399). Accordingly, the majority of the tribunal found the Single Presentation Requirement to be reasonable because it was an attempt to address real public health concerns (paras. 409 and 410). With respect to the 80/80 Regulation, the majority further underlined the importance of deference that has to be given to the state when it has to balance between conflicting considerations, and ultimately held that the 80/80 Regulation was a reasonable measure adopted in good faith to implement an obligation assumed by the state under the FCTC (paras. 418–420).

As mentioned before, arbitrator Gary Born dissented with respect to the FET assessment. He rejected the applicability of the margin of appreciation in the BIT context and found that the Single Presentation Requirement breached FET on the basis that it was arbitrary and irrational and did not bear a logical connection to the policy objective. In his dissenting opinion, he further stated that substantial deference to the regulatory sovereignty of states was essential, but that any measure would still need to satisfy a minimum level of rationality and proportionality.

22 *Glamis v. United States*, UNCITRAL (NAFTA), Award, 8 June 2009, <https://www.italaw.com/sites/default/files/case-documents/ita0378.pdf>.

3.4 Dismissing Legitimate Expectations for a Stable Regulatory Environment as Regards Tobacco Regulations

Philip Morris also claimed that Uruguay breached the FET standard because its legitimate expectation that the regulatory environment would not drastically change had been frustrated.

The tribunal dismissed these arguments and stated that legitimate expectations could not exist when general legislation changes. In particular, such changes were not prevented by the FET standard “if they [did] not exceed the exercise of the host State’s normal regulatory power in pursuance of a public interest and [did] not modify the legal framework relied upon by an investor at the time of its investment ‘outside of an acceptable margin of change’” (para. 423).

The tribunal found that, on the contrary, in the light of the “widely accepted articulations of international concern for the harmful effect of tobacco, the expectation could only have been of progressively more stringent regulation of the sale and use of tobacco products” (para. 430).

Crystallex International Corporation v. Bolivarian Republic of Venezuela, ICSID Case No. ARB(AF)/11/2 (Crystallex v. Venezuela)

The award is available at <https://www.italaw.com/cases/1530>

Keywords: mining, fair and equitable treatment, legitimate expectations, deference,
arbitrariness, methodologies to calculate compensation

Key Dates:

Request for Arbitration: February 16, 2011

Constitution of Tribunal: October 5, 2011

Award: April 6, 2016

Settlement Agreement: November 24, 2017

Arbitrators:

Laurent Lévy (president)

Laurence Boisson de Chazournes (respondent's appointee and
replacing Florentino Feliciano)

Dean John Y. Gotanda (claimant's appointee)

Forum and Applicable Procedural Rules:

International Centre for Settlement of Investment Disputes (ICSID)

ICSID Rules of Procedure for Arbitration Proceedings

Additional Facility (AF)

Applicable Treaty:

Canada–Venezuela Bilateral Investment Treaty (BIT)

Alleged Treaty Violations:

- Expropriation
- Fair and equitable treatment
- Full protection and security

Other Legal Issues Raised:

- Compensation
- Legitimate expectations

1. Importance for Sustainable Development

A state's prerogative to grant or deny permits over its natural resources is an important aspect of state sovereignty. The conditions under which a state grants exploitation permits of its natural resources is an essential element in ensuring that investment activities are in compliance with sustainable development objectives. Consequently, and as the *Crystallex* tribunal held, a foreign investor cannot be "entitled" or have a "right" to an exploitation permit. The tribunal also stated that governmental authorities should enjoy a high level of deference for decisions on permits over natural resource exploitation for reasons of their expertise and competence as well as their proximity with the situation under examination (para. 583). However, the *Crystallex* tribunal, as many other investment tribunals did before, scrutinized the way in which the host state put forward its concerns with a given investment project. In particular for permit denials based on environmental reasons, the tribunal held that states should ensure that they are based on technical studies and scientific research and that they are invoked in a timely and transparent manner. If not, a state runs the risk that its behaviour is considered to be arbitrary and consequently breaching the standard of fair and equitable treatment. Moreover, according to the *Crystallex* tribunal a state is frustrating the legitimate expectations of a foreign investor when a governmental authority made "specific" assurances to the investor. Accordingly, an investor could claim that it had the legitimate expectation of being able to proceed with the investment, fully knowing that the final decision is subject to an environmental permit.

Another relevant element for sustainable development in any investment arbitration is the quantification of the compensation, as it can have meaningful financial consequences for the host state. In the *Crystallex* case, the tribunal calculated the compensation by taking the "lost profits" of the investor into account and concluded the damage to be over USD 1 billion. The tribunal privileged the application of forward-looking valuation methodologies over the backward-looking cost approach. The latter is based on the computation of sunk costs. Forward-looking valuation methodologies are controversial in a case such as *Crystallex* where the mine was not yet producing. In this respect it is interesting to note that the tribunal in the subsequent *Bear Creek v. Peru* case,²³ found—in contrast to the *Crystallex* tribunal—that the forward-looking method was inappropriate for an early-stage and non-producing mining investment. Therefore the *Bear Creek* tribunal held that the claimant be reimbursed only for sunk costs.

2. Case Summary

2.1 Factual Background

Crystallex, a Canadian mining company, acquired the rights to exploit the gold deposits contained in the Las Cristinas gold mine, located within the Imataca National Forest Reserve

23 *Bear Creek Mining Corporation v. Republic of Peru*, ICSID Case No. ARB/14/2, Award, 30 November 2017. Retrieved from <https://www.italaw.com/cases/2848>.

of the Guayana region in Venezuela. Las Cristinas is said to contain one of the world's largest undeveloped gold deposits.

In September 2002, Crystallex entered into a Mining Operation Contract with the Venezuelan state corporation Corporación Venezolana de Guayana (CVG) and sought the necessary permits to commence operations. In May 2007 Crystallex received a letter from the Ministry of Environment assuring it that the authorization would be granted once the company posted a bond (para. 561). Crystallex posted the bond as required, but in April 2008 the Ministry of Environment denied the environmental permit, based on then-stated concerns about the project's impact on the environment and Indigenous Peoples in the Imataca National Forest Reserve (para. 44). In the following, the Venezuelan President of the time, Hugo Chávez, as well as other high-level officials made several public statements expressing the intention of Venezuela to nationalize all its gold mines (paras. 676 *et seq.*).

The dispute between Crystallex and Venezuela occurred due to the denial to grant Crystallex the key environmental permit (the Natural Resources Permit). The subsequent termination of the Mining Operation Contract in February 2011 led Crystallex to initiate arbitration against Venezuela based on the Canada–Venezuela BIT. Crystallex claimed that Venezuela unlawfully expropriated its investment and failed to accord fair and equitable treatment (FET) and full protection and security. Crystallex alleged in particular that the FET standard was breached due to the frustration of its legitimate expectations as well as due to the arbitrary conduct adopted by Venezuelan officials.

2.2 Summary of Legal Issues and Award

In its award of April 6, 2016, the tribunal held that Venezuela had unlawfully expropriated the claimant's investment in the Las Cristinas gold mine project. The tribunal found Venezuela liable for its failure to accord claimant's investment FET. The tribunal awarded the claimant USD 1.202 billion, with each party bearing its own costs. In addition, the tribunal stated that Crystallex was entitled to pre-award interest as well as post-award interest. On 24 November 2017, Crystallex and Venezuela then agreed to settle the dispute. Several parts of the settlement agreement remain sealed, including the final amount to be paid.

3. Select Legal Issues

3.1 Fair and Equitable Treatment: An autonomous treaty standard

The tribunal in *Crystallex* made a clear distinction between those treaties such as the North American Free Trade Agreement (NAFTA) that refer to the international minimum standard of treatment (MST) under customary international law and those, as the one at issue, that do not refer to such minimum standard (para. 530). The latter category of FET clauses constitutes an autonomous treaty standard. The tribunal aligned itself with other tribunals that found that the FET standard is constantly in development (paras. 532–537).

The tribunal (as many others before it) made an attempt to capture the essence of the FET standard (para. 539). Looking at case law, the tribunal made the following statement: “FET comprises, *inter alia*, protection of legitimate expectations, protection against arbitrary and discriminatory treatment, transparency and consistency” (para. 543). Noteworthy is that the tribunal shared the findings of the *Mondev v. United States* tribunal so far as that the state’s conduct need not rise to the level of outrageousness or bad faith to breach the FET standard (para. 543).

3.2 “Specific Representation”: The sine qua non condition for legitimate expectations

According to the tribunal, legitimate expectations may arise in cases where the state’s administration has made a representation to an investor on a substantive benefit. The representation made must be sufficiently “specific.” This means it must be “precise as to its content and clear as to its form” (para. 547).

The tribunal rejected most of the claimant’s alleged expectations as they presented a “circularity of argument” (para. 551) or were “too general and indeterminate” (para. 553) to constitute a frustration of legitimate expectations, and therefore a breach of FET. In contrast, the tribunal accepted the May 16, 2007 letter, as it contains a “specific representation” made to Crystallex that created a legitimate expectation. More precisely the letter stated that once a bond has been posted and approved by the competent office, the authorization “will be handed over” (para. 561). For the tribunal this statement was, in fact, a clear and specific representation made to Crystallex in clear and precise terms (para. 563). Accordingly, the tribunal found that Crystallex had legitimate expectations that the procedure of the permitting process would go ahead for the exploitation of gold. It held that Venezuela frustrated these legitimate expectations by denying the permit in 2008 and thereby breached the FET standard.

3.3 The Finding of Arbitrary Conduct

By seeking to pay deference to Venezuela as regards its decision to deny the exploitation permit, the tribunal adopted a rather low standard of review that assessed whether there have been “serious procedural flaws which have resulted in the Permit being arbitrarily denied, or in the investor being treated non-transparently or inconsistently throughout the process and thereafter” (para. 585).

The tribunal was of the view that, up to the letter of May 16, 2007, “the investor was overall treated in a straightforward manner” (para. 588). With respect to the permit denial letter of April 14, 2008, however, the tribunal concluded that it showed elements of arbitrariness. While the tribunal admitted that Venezuela “had the right (and the responsibility)” to raise environmental concerns and issues of global warming (para. 591), it determined that the way in which Venezuela put these concerns forward was arbitrary because they were newly mentioned and not based on scientific evidence. The tribunal held that the permit denial letter’s reference to global warming was “particularly troublesome” adding that “to raise this concern for the first time in an attempt to justify the denial of the Permit is a clear example of arbitrary and unfair conduct” (para. 592).

The only report on which the permit denial letter appears to be based was the so-called “Technical Inspection Report” of 2006, which was, according to the tribunal, similarly vague in terms as the 2008 letter. For instance, both the report and the letter “blatantly ignored” the “thousands and thousands of pages submitted by Crystallex, ensuing from years of work and millions of dollars of costs” (para. 597). Thus the tribunal considered that Crystallex made huge efforts in cooperation with its main Venezuelan counterpart CVG. The claimant was thus entitled “to have its studies properly assessed and thoroughly evaluated” (para. 597). In addition, the tribunal found a lack of transparency in the circumstance that the permit denial letter does in no way state the reasons for the departure from the conclusions in the 2007 letter. Further considering the statements of Hugo Chávez and other high governmental officials, the tribunal found that the claimant was subject to a “roller-coaster” of contradictory and inconsistent statements” (para. 606). All these elements led the tribunal to conclude that Venezuela adopted a clear form of arbitrary conduct and thus breached the FET standard (para. 614).

3.4 Expropriation—A state can only be found to have expropriated an investment if it acted in its sovereign capacity

The tribunal found Venezuela to have indirectly expropriated the claimant’s investment through a series of acts. The tribunal held that the expropriatory action started with the permit denial of 2008, continued with the public statements by high governmental officials following the permit denial, which evidenced Venezuela’s intention to nationalize Las Cristinas, and culminated with the rescission of the Mining Operation Contract, leading to the deprivation of the claimant’s investment. The tribunal thus concluded that the state’s measure constituted a creeping expropriation (para. 685).

With respect to the Mining Operation Contract, the tribunal agreed with Crystallex and Venezuela that for a state action rescinding a contract to be considered as an expropriation under international law, the state must have acted in the exercise of its sovereign powers and not merely as an ordinary contracting party (paras. 690–692). In the present case, the tribunal concluded that the termination of the contract was one of an exercise of sovereign authority (para. 700). First and foremost, tribunal was convinced by the evidence that the Mining Operation Contract was terminated “to give effect to the superior policy decisions dictated by higher governmental spheres” (para. 701).

Based on the finding that a creeping expropriation existed of the claimant’s investment, the tribunal looked at whether the conditions of a lawful expropriation were met (expropriation must be carried out for a public purpose, under due process of law, in a non-discriminatory manner, and against prompt, adequate and effective compensation). It accepted Venezuela’s argument that the expropriation was carried out in pursuit of a public interest objective and underlined that states enjoy “a wide margin of appreciation in determining whether an expropriation serves a public purpose” (para. 712). The claimant, in return, failed to establish that the expropriation was carried out in disrespect of due process or to provide facts in support of a discriminatory treatment. However, Venezuela never compensated Crystallex. Given that the condition of the payment of a prompt, adequate and effective compensation was not met, the tribunal held that Venezuela illegally expropriated Crystallex’s investment, breaching the BIT.

3.5 Valuation of Compensation—What is the right methodology?

The applicable BIT, like most investment treaties, does not address the principles governing quantification of damages for breaches of treaty provisions other than expropriation. Therefore, the tribunal decided to apply the “full reparation” standard under customary international law (para. 846). By applying this standard, the tribunal sought to calculate the damage so as to restore the investor in the position as if the treaty breach had not occurred. It namely relied on *Starrett Housing Co v. Iran* as well as *CMS v. Argentina* and found that the consequences of the treaty breaches are to be determined by using the “fair market value” methodology.

As regards the valuation date, the tribunal agreed with Venezuela that April 13, 2008 was the appropriate valuation date, as it was the day before the denial of permit, which the tribunal saw as the first act leading to the deprivation of the claimant’s investment. Furthermore, the tribunal held that the claimant bears the burden of proof “in relation to the fact and the amount of loss” (para. 864). As for the standard of proof, the tribunal listed principles guiding the tribunal’s approach, such as the existence of damage must be proved “with certainty” (para. 867); the exact quantification does not need to be proven with the same degree of certainty, since future damage is inherently difficult to prove and the “with reasonable confidence” standard from *Lemire v. Ukraine* was adopted as satisfactory to both common and civil lawyers (paras. 868-869); and lastly, the impossibility or difficulty of proving damages with precision does not bar their recovery altogether (para. 871).

According to the tribunal, the fact of future profitability was sufficiently proven by the claimant’s exploration activities, and in taking into consideration that the nature of the project was an open pit gold mine—an asset whose costs and future profits can be estimated with greater certainty than other assets—which are subject to greater market fluctuations (para. 879).

In order to determine the fair market value of the investment, the tribunal accepted the claimant’s forward-looking loss of profit valuation methodologies over the backward-looking cost approach (aimed at considering Crystallex’s expenditures in the investment) proposed by Venezuela (para. 882). According to Crystallex, its expenditures amounted to USD 644.8 million (para. 892).

Finally, the tribunal considered the four forward-looking valuation methods proposed by Crystallex. It accepted as reliable the stock market approach and the market multiples method, but considered as problematic the price to net asset value (P/NAV) method for not providing reliable figures and also the indirect sales comparison method for yielding excessively speculative results. As the two chosen approaches led to comparable results on quantum the tribunal averaged the two figures to give a damages award of USD 1.202 billion (para. 917). Finally the tribunal ordered pre- and post-award interest at the rate of the 6-month average U.S. dollar LIBOR plus one per cent compounded annually (para. 940).

William Ralph Clayton, William Richard Clayton, Douglas Clayton, Daniel Clayton and Bilcon of Delaware Inc. v. Government of Canada, UNCITRAL, Permanent Court of Arbitration (PCA) Case No. 2009-04 (Clayton/Bilcon v. Canada)

Award available at <https://www.italaw.com/sites/default/files/case-documents/italaw4212.pdf>

Keywords: Environmental regulation, environmental assessment, fair and equitable treatment, international minimum standard of treatment, legitimate expectations, procedural and substantive fairness, arbitrariness

Key Dates:

Notice of Arbitration: May 26, 2008

Constitution of Tribunal: April 9, 2009

Award on Jurisdiction and Liability: March 17, 2015

Application to the Federal Court of Canada for Set Aside of the Award: June 16, 2015

Decision on Setting Aside the Award: May 2, 2018

Arbitrators:

Bruno Simma (president)

Donald McRae (respondent appointee)

Bryan Schwartz (claimant appointee)

Forum and Applicable Procedural Rules:

Permanent Court of Arbitration (PCA)

UNCITRAL Arbitration Rules (1976)

Applicable Treaty:

North American Free Trade Agreement (NAFTA), Chapter Eleven, Investment

Alleged Treaty Violations:

- Minimum standard of treatment
- Most-favoured-nation treatment
- National treatment

Other Legal Issues Raised:

- Jurisdiction—Attribution
- Jurisdiction—Timeliness of claims

1. Importance for Sustainable Development

When the *Bilcon v. Canada* award was rendered in 2015, it came as a surprise, especially for those who considered that investment arbitration had shifted toward a better balance between public and private interests. Indeed, the approach taken by the Bilcon tribunal reminded critiques of the earliest investor–state disputes involving environmental matters when government and civil society were taken aback about the lack of deference shown by arbitral tribunals vis-à-vis governmental action to protect the environment.

The case involved the rejection of a project to develop and operate a quarry in Nova Scotia. After a preliminary approval, a Joint Review Panel was mandated to conduct an environmental assessment. In its final report, the Joint Review Panel recommended the rejection of the project. The significant and adverse environmental effect on the “community core values” were the main reason for the Joint Review Panel to reject the project.

The majority of the tribunal found that the process applied by the Joint Review Panel was in breach of the investors’ legitimate expectations, which were based on federal and provincial law as well as specific representations by government officials who repeatedly encouraged Bilcon to pursue the project. It is striking that in its assessment on the legitimate expectations, the tribunal does in no way take into account the broader public policy concerns or weigh the investor expectations against the objectives of sustainable development, including the protection of the environment. The tribunal also questioned the legality of the concept of “community core values.” In so doing, the tribunal applied an arguably inappropriate threshold in finding arbitrariness, and concluded that Canada breached the minimum standard of treatment under the North American Free Trade Agreement (NAFTA).

The *Bilcon* award feeds into the current debate on better balancing between investors rights and legitimate expectations on the one hand, and public policy interests on the other. The deference accorded to the investors’ expectations and the low threshold in finding arbitrariness goes in a problematic direction and certainly in the opposite direction of current reform trends. At the very best, the Bilcon award is a reminder that substantive investment rules need to be modified so that investment treaties more adequately respond to the demand for balanced treaties. In particular, the broad all-encompassing standards such as the minimum standard of treatment and fair and equitable treatment will continue to pose problems, especially if they continue to refer to terms such as arbitrariness and legitimate expectations.

A further implication of the Bilcon award has been underscored by the dissenting arbitrator, which is the issue of regulatory chill. The majority second-guessed the environmental assessment procedure under Canadian law. Such second-guessing arguably means a significant intrusion into the domestic legal system of a state and could lead to a chill on the operation of environmental review panels. As though aware of the controversial character of its own finding and its potential negative impacts, the majority of the tribunal added in an *obiter dictum* that “[e]nvironmental regulations, including [environmental impact] assessments, will inevitably be of great relevance for many kinds of major investments in modern times” (para. 597). It continued to underline that “[t]he Laws of Canada and Nova Scotia, as well as the NAFTA itself, expressly acknowledge that economic development and environmental integrity

can not only be reconciled but can be mutually reinforcing” (paras. 595–601). The tribunal shows through this *obiter dictum* that it is fully aware of the need to reconcile environmental protection and economic development through mutually supportive solutions. The reasoning and outcome of the case seems thus even more puzzling.

2. Case Summary

2.1 Factual Background

The Clayton family group (Messrs. William Ralph, William Richard, Douglas and Daniel Clayton) and Bilcon of Delaware (Bilcon) sought to invest in a quarry and a marine terminal in the Canadian province of Nova Scotia at Whites Point in Digby Neck (the project). In 2002 the investors entered into a partnership agreement with a Nova Scotia company, Nova Stone Exporters, to develop and operate the proposed project.

The proposed project required a permit and approvals to conduct blasting operations. From 2003 onwards, it underwent a lengthy environmental assessment (EA) jointly conducted by the governments of Canada and Nova Scotia. After the two governments realized that the project raised widespread public concern and potentially significant adverse environmental effects, the EA was referred to a Joint Review Panel (JRP). Such JRPs can be mandated through an agreement between the federal government and authorities from another jurisdiction, including provinces, according to the Canadian Environmental Assessment Act (CEAA).

Nova Scotia entered into an agreement with the federal government (Canada–Nova Scotia Agreement) setting out the guidelines and scope of the JRP’s review of the project. The JRP had to objectively assess any adverse effects the project may have on the environment and assess possible mitigation measures. The JRP’s mandate also included an assessment of the effects on the human environment and traditional lifestyle, values and culture.

In its final report, the JRP recommended the rejection of the project because it would have significant and adverse environmental effect on the “community core values” of Digby Neck. At the end of 2007, the Nova Scotian and Canadian governments rejected the project on these grounds.

2.2 Summary of Legal Issues and Award

Following the rejection of the project, Bilcon initiated arbitration against Canada. Bilcon alleged that the environmental regulatory regime of Canada and Nova Scotia was applied to its project in an arbitrary, discriminatory and unfair manner.

A majority of the tribunal found Canada liable for having breached the minimum standard of treatment obligation under NAFTA Article 1105(1). On the one hand, it held that the JRP process breached the investor’s legitimate expectations, which were based on federal and provincial law and specific encouragements by government officials. On the other hand, it

found the JRP process to be arbitrary in creating a new standard of assessment, that is, the “community core values” standard. The tribunal also found a breach of the national treatment standard under NAFTA Article 1102, in that the JRP evaluation used more stringent criteria than those imposed on Canadian investors in like circumstances.

Professor McRae, the arbitrator appointed by Canada, issued a dissenting opinion. He disagreed with the findings on the minimum standard of treatment. In his opinion, even if Canada had breached its proper laws, this fact could not amount to an international breach of NAFTA Article 1105(1). McRae also disagreed with the majority’s finding on the violation of the national treatment standard.

The tribunal deferred the calculation of damages; the investors have initially claimed USD 300 million. The decision is pending at the time of writing.

In June 2015, the government of Canada applied to the Federal Court of Canada to have the NAFTA tribunal decision set aside on the grounds that it “contains decisions on matters beyond the scope of the submission to arbitration” and that it contradicts Canada public policy. On May 2, 2018, the Federal Court dismissed the application of Canada. The judge held: “I accept that the majority’s Award raises significant policy concerns. These include its effect on the ability of *NAFTA* Parties to regulate environmental matters within their jurisdiction, the ability of *NAFTA* tribunals to properly assess whether foreign investors have been treated fairly under domestic environmental assessment processes, and the potential ‘chill’ in the environmental assessment process that could result from the majority’s decision.” Despite this the federal court judge was unable to set aside the decision due to the court’s very limited ability to review arbitration awards.

3. Select Legal Issues

3.1 Minimum Standard of Treatment: Significant deference to the investor’s stated expectations

In assessing whether Canada had violated the minimum standards of treatment, the majority of the *Bilcon* tribunal followed the formulation of the international minimum standard by the *Waste Management*²⁴ tribunal (paras. 442–445). According to *Waste Management*, “the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety” (para. 442). The majority of the *Bilcon* tribunal further emphasized that the current international minimum standard had evolved to provide greater protection than that under the *Neer* case, pursuant to which an international breach was limited to “outrageous” state conduct (para. 444).

24 *Waste Management, Inc. v. United Mexican States (“Number 2”)*, ICSID Case No. ARB(AF)/00/3
<http://www.italaw.com/cases/1158#sthash.HFSe2PkN.dpuf>

Bilcon had argued that its legitimate expectation to operate the quarry had been frustrated. According to Bilcon, those expectations arose from extensive encouragement of Nova Scotia officials. The investors also expected that the project would be assessed in accordance with Canadian law. The majority followed the investor's argument stating that the *Waste Management* test requires the examination of specific representation made by the host state on which an investor relied to its detriment. The majority found that Nova Scotia officials made such specific representation and that the general investment promotion materials and policy statements of Nova Scotia showed that Bilcon has been clearly and repeatedly encouraged to pursue the project. The majority also found that Bilcon had legitimate expectations that Canadian law would be properly applied but that this was ultimately not the case. The approach of the majority of the *Bilcon* tribunal signals that an identified breach of domestic law by a host state can amount to a breach of legitimate expectations.

In his dissenting opinion, McRae argued that whether Nova Scotia officials encouraged the investment and, thus, created "legitimate expectations" is irrelevant for the assessment of the NAFTA standard because representations by state officials could create no legitimate investor expectations beyond the default expectation of compliance with domestic law. Thus, Bilcon's only legitimate expectation could have been that Canadian law would be properly applied. According to McRae it was not settled whether there was in fact a breach of Canadian law. At any rate, he stressed that the mere fact that an investor alleges a breach of national law cannot amount to a breach of the NAFTA standard (para. 36 of the dissenting opinion).

3.2 Minimum Standard of Treatment: The issue of "community core values"

In assessing the minimum standard of treatment, the majority of the tribunal followed this line of reasoning by the claimant that the conduct of the EA was unfair and arbitrary due to the fact that the JRP report introduced the term "community core values," which is not as such mentioned in any statute, regulation or guidelines of Nova Scotia or Canada (para. 503). In short, the reasoning suggests that deviating from national law meets the threshold of arbitrariness. In its application of the *Waste Management* standard, the majority found that "community core values" was an arbitrarily applied standard without legal authority. The majority stressed that this novel standard played the most prominent role in the assessment even though the meaning of this standard appeared to be unclear (paras. 505–506). The award stated four possible meanings: first, "community core values" could refer to the local community's majority opinion of whether the project should be accepted or rejected; second, it could mean values espoused in local policy statements and documents (press releases, action plans); third, the community's right to determine for itself rather than allowing the local and national government to make the ultimate decision on the project; or lastly, the term could signify "community DNA" as meaning the community's traditions and lifestyles that distinguish it from other communities.

The majority of the *Bilcon* tribunal found that irrespective of its actual meaning, the “community core values” standard went beyond the JRP’s mandate (para. 535). The majority also held that the JRP report did not propose any mitigation measures which was contrary to the JRP’s mandate. This failure prejudiced the investor, in the majority’s view. Finally, the majority found that Bilcon lacked reasonable notice of this approach and thus concurred that Bilcon had been denied a fair opportunity to know about the new standard and how to meet and to address it (para. 543).

As mentioned, the JRP had a mandate to identify human environment effects. The question thus arose whether the term “community core values” was really a novel or extra-legal term. According to McRae, the term “community core values” used by the JRP was merely a restatement encapsulating the various human environmental effects the project can have and these components fell indeed under the JRP mandate. Human environmental effects can refer to elements such as the historical use of the area, fishing, eco-tourism, the quality of life, air and water, and the health of the community. He underlined that the JRP report also concluded that Bilcon failed to provide adequate analysis of the human environmental effects of the project on local communities.

The majority’s interpretation of the international minimum standard of treatment is significant in several ways. First because it points to the potential lack of expertise of investment arbitrators regarding environmental law and the functions of an EA review panel. Second, it also demonstrates the lack of deference on behalf of the majority vis-à-vis the host state’s legislation on environmental protection and its application through host state institutions and processes.

3.3 National Treatment

Another interesting aspect of the *Bilcon* award is how the tribunal analyzed the national treatment standard under NAFTA. The majority found that the EA procedures imposed on Bilcon constituted a treatment less favourable than Canadian investors in like circumstances received. The majority rejected Canada’s argument to restrict comparators to investments or investors to those that, like Bilcon, were undergoing a JRP review or those projects with significant opposition from a local community. The majority held that the broad language in Article 1102 of NAFTA and NAFTA’s general objective to increase investments signified that the range of comparators should be broader. In comparing the assessment procedures of a number of similar mining projects, the majority found that projects were not evaluated in terms of “core community values” and thus received more favourable treatment (para. 696). This type of broad interpretation of national treatment will make it difficult for governments to take into account specific environmental and societal differences of projects without being found in breach of the national treatment provision.

3.4 Potential Implications for National Environmental Review Processes

McRae cautioned that the majority's award risks chilling national environmental review processes that focus on impacts to the human environment, because such processes could potentially result in a claim for damages under NAFTA. Furthermore, he highlighted that a failure to comply with Canadian law by a review panel would now become the basis for a NAFTA claim and allow a claimant to bypass the domestic remedy under Canadian law. According to Professor McRae, such intrusion into domestic jurisdiction will create a chill on the operation of environmental review panels (para. 48 of the dissenting opinion). The majority included additional observations on the award, pointing out that a NAFTA tribunal must be sensitive to possible "regulatory chill" including environmental regulatory chill. Thus, it is interesting to note that the majority reiterated that the circumstances of the case were very specific and exceptional and should therefore not result in a general regulatory chill on environmental matters.

The extent to which there will be a regulatory chill is difficult to assess at this point. However, the *Bilcon* award, even though rendered in 2015, follows the line of earlier investor-state disputes in which the arbitrators do not take into account non-investment issues or do so insufficiently. This runs counter to the progress that has been made in the last years in shifting arbitrators' attitudes toward non-investment issues within investment arbitration and underscores the threat that investment arbitration poses to a state's regulatory space.

Metal-Tech Ltd. v. The Republic of Uzbekistan, ICSID Case No ARB/10/3 (Metal-Tech v. Uzbekistan)

The award is available at <https://www.italaw.com/sites/default/files/case-documents/italaw3012.pdf>

Keywords: Corruption, burden of proof, standard of proof, transparency

Key Dates:

Request for Arbitration: January 26, 2010

Constitution of Tribunal: August 3, 2010

Award: October 4, 2013

Arbitrators:

Gabrielle Kaufmann-Kohler (president)

Claus von Wobeser (respondent appointee)

Geraldine Fischer (claimant appointee)

Forum and Applicable Procedural Rules:

International Centre for Settlement of Investment Disputes (ICSID)

ICSID Rules of Procedure for Arbitration Proceedings

Applicable Treaty:

Israel–Uzbekistan Bilateral Investment Treaty (BIT)

Alleged Treaty Violations:

- Expropriation
- Fair and equitable treatment
- Full protection and security

Other Legal Issues Raised:

- Counterclaim
- Import of Definition of investment through most-favoured-nation (MFN) clause
- Jurisdiction
- Legality of investment

1. Importance for Sustainable Development

Corruption undermines the economic development of a country as well as the achievement of good governance; both are important for the sustainable development of the host state. Investment tribunals are not per se the appropriate bodies to punish acts of corruption. They are, however, frequently confronted with a party or parties to a dispute that have engaged into acts of corruption. Issues of corruption typically arise when a respondent invokes corruption as a defence on the merits or as a counterclaim. Yet corruption defences are rarely successful due to the lack of evidence.

The award of *Metal-Tech v. Uzbekistan* is an example of a successful corruption defence.²⁵ The tribunal dismissed its jurisdiction due to corruption related to Metal-Tech's investment in Uzbekistan. In its decision to dismiss Metal-Tech's claims on the ground of lack of jurisdiction, the tribunal relied mainly on the interpretation of the applicable BIT, which defined "investment" as "any kind of assets, implemented in accordance with the laws and regulations of the Contracting Party in whose territory the investment is made." The tribunal interpreted this requirement to mean that the investment must be made "in compliance with the law at the time when it was established" (para. 193), and that in case of non-compliance the dispute would not fall under its jurisdiction. Thus, according to the tribunal's interpretation, corruption during the establishment of the investment must lead to a dismissal of jurisdiction. It leaves open, however, the question whether corruption occurring after the establishment of the investment, that is, in the course of its operation, would lead to a similar or different consequence.

The approach taken by the Metal-Tech tribunal is also interesting because the tribunal decided to undertake an *ex officio* investigation on whether or not the establishment of the investment was flawed by corruption. In this respect, it found that enough evidence existed based on an application of the "red flags" list. The red flags are a set of indicators that can serve as a tool to detect instances of corruption. Red flags are thus only indicators and not conditions for a finding of corruption. They serve to establish circumstantial evidence

In the present case, Uzbekistan was able to invoke Metal-Tech's corrupt conduct as an absolute bar of its own liability under international law. The company remains equally free of liability at the international level. Awards like *Metal-Tech v. Uzbekistan* could serve as an incentive, nevertheless, to increase the level of due diligence of foreign investors when choosing to establish in the territory of a host state offering investment opportunities. However, if the consequence for the investor is simply to lose access to international arbitration, more may be needed to increase the responsibility of investors not to engage in corruption when investing across the border.

25 *World Duty Free v. Kenya* is another example where tribunals accepted a defence based on corruption. *World Duty Free Co. Ltd. v. Republic of Kenya*, ICSID Case No. ARB/00/7, Award of October 4, 2006. Retrieved from <https://www.italaw.com/cases/documents/3281>.

2. Case Summary

In 2000, Metal-Tech entered into the joint venture Uzmetal with two Uzbek state-owned enterprises (SOEs). The purpose of the joint venture was to build and operate a modern plant to produce molybdenum in Uzbekistan (para. 7). Subsequently, Metal-Tech concluded three consulting agreements having a total value of USD 4.4 million with individuals that were closely connected to the Uzbek government. In the course of 2006 and 2007, the two SOEs filed domestic court proceeding against Uzmetal seeking the distribution of dividends of their shares. Uzmetal was ordered to distribute the unpaid dividends but did not do so. As a consequence the two SOEs initiated bankruptcy proceedings against Uzmetal. In 2007, the Court of the Tashkent Region awarded the liquidation and transfer of all Uzmetal's assets to the two SOEs (para. 34 et seq.). In January 2010, Metal-Tech then submitted a Request for Arbitration to ICSID. Metal-Tech claimed violations of Uzbek laws as well as a breach of the fair and equitable treatment standard, of full protection and security and of expropriation contained in the Israel–Uzbekistan BIT (para. 107). It sought compensation of approximately USD 174 million.

Uzbekistan's principal defence was that the tribunal lacked jurisdiction because Metal-Tech's investment was "made and operated corruptly" and in violation of Uzbek laws on bribery (para. 110). The tribunal ultimately found corruption to have existed with respect to two of the three consulting agreements. The investment was thus established illegally, and therefore the tribunal declined its jurisdiction.

3. Select Legal Issues

3.1 Standard of Proof: The red flags of corruption

The tribunal first set out that since the international responsibility of Uzbekistan is at stake, it would be appropriate to apply international law to the burden of proof. It indicated that the general rule and widely recognized principle under international law is that each party bears the burden of proving the facts on which it relies (para. 237).

In the case of corruption, however, the tribunal questioned whether the burden of proof should not be shifted from the respondent to the claimant, so that the latter has to establish that there was no corruption (para. 238). The tribunal explained that usually such shift would be foreseen in the applicable law, but that the BIT in question was silent on this matter. Consequently, in the opinion of the tribunal, it disposed of relative freedom in determining the principles to sustain a determination of corruption.

The tribunal found that the facts submitted by Uzbekistan and those mentioned during the hearings created "the suspicions of corruption" (para. 239). In particular, it highlighted that payment of a sum of more than USD 4 million to consultants raised suspicion (para. 240). Thus, in a procedural order, the tribunal exercised its ex officio power to ask Metal-Tech for additional evidence that it was not engaged in corruption (para. 241). By doing so the tribunal accepted to reverse the burden of proof on Metal-Tech.

The tribunal stated that “corruption is by essence difficult to establish and that it is thus generally admitted that it can be shown through circumstantial evidence” (para. 243). In corruption cases, circumstantial evidence is frequently referred to as indicators or so called “red flags” of corruption. According to the tribunal, the several lists of these red flags can be worded differently, but they have essentially the same content (para. 293). The tribunal used six factual findings as constituting a “red flag” of corruption: the amount of payments, the fact that there was no proof of services, the lack of qualification of the consultant, the sham consulting contracts, the lack of transparency of the payee, and the connections of the consultants with public officials in charge of Metal-Tech’s investment.

As regards the proof of services, the tribunal sought to understand what services the payments were intended to compensate. It gave Metal-Tech an opportunity to substantiate the legitimacy of the services. For instance, in one of the consulting agreements, the consultants were to visit Israel. The tribunal thus asked for evidence for such travels; however, Metal-Tech was unable to provide them. Metal-Tech tried to justify it by arguing that many documents were left in Uzbekistan after the enterprise left the country, but the tribunal found such explanations unrealistic. In addition, it held that the few documents that were provided by Metal-Tech—such as the minutes of the General Meetings of Uzmetal—were useless as they did not illustrate what services the consultants rendered (paras. 257–261).

The tribunal stressed more than once that Metal-Tech was not concealing evidence. Rather, it found that Metal-Tech was unable to provide evidence of services because no services or at least no legitimate services were performed at the time of the establishment of the investment (para. 265). Applying the “red flags” analysis, the tribunal concluded that there was sufficient circumstantial evidence to find that corruption existed with respect to two of the three consulting agreements. It then analyzed whether this affected the legality of Metal-Tech’s investment.

3.2. The Legality of the Investment

Many BITs contain differently framed “in accordance with host state law” clauses. Investment tribunals generally consider such clauses as having the effect of excluding illegal investment from protection under the BIT. However, there is no unanimous approach on whether illegality is a matter affecting the jurisdiction of the tribunal, the admissibility of the claim, or the merits of the case.

Article 1(1) of the Israel–Uzbekistan BIT defines investment as meaning “any kind of assets, implemented in accordance with the laws and regulations” of the host state (para. 164). According to the tribunal, the scope of the legality requirement covers not any kind of violation of host state laws; it has to be a non-trivial violation. At any rate, according to the tribunal, corruption falls within this scope. The BIT provision by referring to “implemented in accordance” with the host state law refers to the time when the investment was made, but is silent on whether it must also be *operated* in accordance with the laws of the host state after it is in place (para. 193).

The tribunal analyzed Uzbek law and concluded that: (i) it is unlawful to give or to promise anything of value to a public official or an intermediary of that public official in exchange for the performance or non-performance of a certain action that the official must or could have performed; (ii) it is unlawful to enrich a third party, such as a member of an official's family, to induce an official's performance or non-performance of certain action; and (iii) the timing of payment is irrelevant; it can occur before or after the act or omission sought (para. 289). The tribunal held that Uzbek law is in conformity with international law and the laws of the vast majority of states.

In addition, the tribunal pointed to the adoption of several international legal instruments to combat corruption, such as the Code of Conduct for Law Enforcement Officials and the Declaration against Corruption and Bribery in International Commercial Transaction, both adopted by the United Nations General Assembly. It referred also to other legal instruments elaborated by the African Union, the Council of Europe and the Organisation for Economic Co-operation and Development (OECD). Lastly, the tribunal referred to the award in *World Duty Free v. Kenya*, which held that corruption is “contrary to international public policy of most, if not all States, or to use another formula, to transnational public policy” (paras. 289–291). Against this legal framework the tribunal analyzed each consulting contract separately. For each consultant, the tribunal scrutinized the legality by taking into account the factual circumstances circumscribed by the “red flags” mentioned above.

In conclusion, the tribunal found that the fact that two of the consulting agreements were made through corruption affected the legality of the establishment of the investment, which was thus not “implemented in accordance” with the laws of Uzbekistan. The tribunal held that “Uzbekistan’s consent to ICSID arbitration, as expressed in Article 8(1) of the BIT, is restricted to disputes concerning an investment, as defined in Article 1(1) of the BIT.” The tribunal held that the dispute did not “come within the reach of Article 8(1) and [was] not covered by Uzbekistan’s consent” (para. 373). The tribunal, thus, declared that it lacked jurisdiction over the dispute.

3.3 Shared Responsibility With Respect to the Corrupt Conduct

The tribunal underscored an important point with the following remark: “[w]hile reaching the conclusion that the claims are barred as a result of corruption, the Tribunal is sensitive to the ongoing debate that findings on corruption often come down heavily on claimants, while possibly exonerating defendants that may have themselves been involved in the corrupt acts. It is true that the outcome in cases of corruption often appears unsatisfactory because, at first sight at least, it seems to give an unfair advantage to the defendant party. The idea, however, is not to punish one party at the cost of the other, but rather to ensure the promotion of the rule of law, which entails that a court or tribunal cannot grant assistance to a party that has engaged in a corrupt act” (para. 389). This statement specifically points to the difficulties of cases where corruption is involved. Uzbekistan was in this case able to invoke Metal-Tech’s corrupt conduct as an absolute bar of its own liability under international law. The company remains equally free of liability at the international level.

Lastly, the tribunal acknowledged that Uzbekistan had also participated in the corrupt conduct through the allocation of costs. In the present case, the tribunal ordered each party to bear its own costs. The tribunal thereby seems to have tried to remedy that the investor bears alone the consequences of the corrupt conduct, stating that “[b]ecause of this participation, which is implicit in the very nature of corruption, it appears fair that the Parties share in the costs” (para. 422).

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Head Office

111 Lombard Avenue, Suite 325
Winnipeg, Manitoba
Canada R3B 0T4

Tel: +1 (204) 958-7700
Website: www.iisd.org
Twitter: @IISD_news



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