U.S. VIETNAM TRADE COUNCIL EDUCATION FORUM

Investor-State Arbitration Under ICSID, the ICSID Additional Facility and the UNCTAD Arbitral Rules

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I. Introduction

Investor-host state arbitration has become a common occurrence in the 40 years since the ICSID Convention was concluded, particularly during the past ten years. (The first case was not decided until 1974**). As of September 2003, 124 cases had been registered since 1965, of which 63 were pending.** There have been decisions in more than a dozen cases under NAFTA, Chapter 11 (the majority under the ICSID Additional Facility rules), and more than 30 notices of arbitration, about **60%** of which are between the United States and Canada (the remainder with Mexico). At ICSID, there are currently over 30 cases pending against Argentina alone, all relating to the actions taken by the Government of Argentina in 2002 to deal with the foreign exchange crisis and financial difficulties. There are now more than 2100 bilateral investment treaties ("BITs") in force, the majority (but not all) between OECD countries and developing nations; most of these BITs provide for binding international arbitration of disputes between investors and host states.

Presumably, the explosion of BITs means that many developing nations believe that the existence of BITs with capital exporting countries is a factor in encouraging foreign investment. This is probably particularly true of some smaller developing countries. Major multinational enterprises see a presence in China (and, increasingly, in India, and to some extent, in Brazil) as an economic imperative. However, few other countries enjoy that status. While there is little evidence to suggest that the existence of BITs is a controlling factor in foreign investment decisions, there is little doubt that investors consider the existence of BITs as one of the key indicators of a favorable investment climate. While relatively few investment disputes will ever be the subject of international arbitration, governments that accept obligations regarding treatment of foreign investment under an international treaty are probably more likely to comply with those obligations in their dealings with foreigners (and, perhaps, with their own nationals) than some of those, which have not accepted such obligations.

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Vietnam has concluded over 25 BITs, including BITs with Australia, China, the Netherlands, South Korea, France, Germany and the Russian Federation, among others. For this discussion, we focus on Chapter IV of the United States – Vietnam Bilateral Trade Agreement, and **the** Vietnamese BITs with Japan and **South Korea, concluded in 2003**.

The use of investment protection agreements such as BITs has been significantly affected by the jurisprudence developed under NAFTA. More than 20 cases have been filed under NAFTA, Chapter 11, and there have been more than a dozen definitive decisions. What is probably most important is that for the first time, a BIT type instrument has generated considerable litigation between investors of two developed countries (the United States and Canada), as about 60% of the actions have been filed against those countries rather than against Mexico. For the first time in the many years since it was created, the ISCID Additional Facility has been used frequently, since neither Canada nor Mexico is party to ICSID. **The cases against the United States and Canada have** changed the perceptions of BITs in both the U.S. and the Canadian governments; no government likes to be sued in an international arbitration, **but for Canada and the United States the experience is very recent!** In two cases each, Canada and Mexico have been directed to pay compensation to U.S. investors. One result, **even though the United States has yet to lose a Chapter 11 case,** is changes in the **2004** "model" U.S. BIT and in the investment provisions in subsequent **U.S.** FTAs, such as those with Singapore, Chile, the Central American countries, etc. However, application of NAFTA decisions to disputes not covered by NAFTA requires care. NAFTA Chapter 11 contains specific provisions (like **many** BITs) that depart from general rules.

It is impossible to deal with all of the issues relevant to investor - host state arbitration in a single day. In fact, there is no uniform set of rules. Most such arbitrations are conducted under the ICSID Rules, the ICSID Additional Facility Rules, or the UNCITRAL Rules. These rules have been interpreted by tribunals (and by the ISCID Secretariat), but many questions remain. Three other factors reduce the precedential value of tribunal decisions. First, there is no equivalent of the WTO Appellate Body to establish consistency of interpretation of investment rules, although the U.S. and some of its FTA partners are exploring such a concept. Secondly, the basic arbitral rules are often modified by the provisions of particular BITs, or as in Chapter 11 of NAFTA or Chapter IV of the VBTA. Thirdly, these disputes tend to be decided on a case-by-case basis, after careful analysis of particular facts, especially when issues of "fair and equitable treatment" or indirect expropriation have arisen. Fourth, a significant number of decisions do not become public. Some recent cases (e.g., *OEPC v.* Ecuador) appear to treat investors very favorably; others (e.g., *Waste Management v. Mexico*) appear to be **more** deferential to the host state. Thus, predicting what a tribunal will do in a specific fact situation is a very inexact science.

II. Relevant International Agreements

A. ICSID Convention

The ICSID Convention, concluded in 1966, now has over 150 parties, including most of the major capital importing and exporting nations. (There are some key exceptions, including Canada, Mexico, Poland, Brazil and, of course, Vietnam.)

The Convention is largely **but not entirely** procedural **and jurisdictional**; it and the ICSID Arbitration Rules govern investor - host state arbitrations held under its umbrella. Issues covered include:

requests for arbitration
constitution of the tribunal
powers and functions of the tribunal
limitations on ICSID jurisdiction (nationality, scope of "investment")
role of the Secretary General in registering actions
the award
interpretation, revision and annulment of the award
mandatory recognition and enforcement of the award

Many of the details are supplied in the ICSID Arbitration Rules, which must be read in conjunction with the Convention. (The Additional Facility Rules, applicable as they are to non-ICSID parties, are self-contained.)

The cases before ICSID are only those in which both parties have consented in writing to submit their disputes to the Centre's jurisdiction. Becoming a party to the Convention does not at the same time constitute agreement to submit any disputes to ICSID's jurisdiction; that is usually done in a BIT or separate agreement, such as in Article 4:4 of Chapter IV of the VBTA. However, under Article 25(1) of the Convention once a party to a dispute (private or government) gives consent such consent may not be withdrawn.

ICSID provides both under the Convention and in the Additional Facility Rules for conciliation through the efforts of the ICSID Secretary General. To date, only about 2% of the cases before ICSID have involved conciliation, but the new Secretary-General, Roberto Dañino (of Peru) has indicated his intention to encourage greater use of conciliation as a quicker and less expensive (but non-binding) means of dispute resolution.

B. New York Convention on the Enforcement of Foreign Arbitral Awards

The New York Convention, concluded in 1958, has approximately 134 parties, including Vietnam. It is notable that unlike the ICSID Convention, the New York Convention applies to disputes among private parties as well as to investor - host state disputes.

Many states have taken reservations, the most common being the limiting of the enforcement obligations to awards that have been made in the territory of other contracting parties. The United States and Canada (except for Quebec) and some many other states have limited application of the Convention to disputes which are "commercial" in nature under national law. Norway does not apply the Convention to disputes over real property in Norway, or rights in such property. Some states limit the Convention to arbitral awards adopted after the Convention became effective. Argentina declares that the Convention "should be construed in accordance with the principles and rules of the National Constitution in force or with those resulting from reforms mandated by the Constitution." Vietnam has a somewhat similar reservation, declaring that "interpretation of the Convention before the Vietnamese courts or competent authorities should be made in accordance with the Constitution and the law of Vietnam." **However, Vietnam interprets the "commercial" exception in a very narrow manner, i.e., as permitting the enforcement of awards only when the matter were to be covered by Vietnam's Commercial Code.**

This is a significant departure from normal practice. While the determination of what is "commercial" is made under national law, our understanding is that most states provide a flexible and broad interpretation of "commercial" in enforcing awards. States that have adopted the UNCITRAL Model Law on Commercial Arbitration may refer to the definition in that instrument when deciding how to interpret the term for enforcement of awards under the New York Convention. The Model Law states that

> **The term "commercial" should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods or services; distribution agreement; commercial representation or agency; factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business cooperation; carriage of goods or passengers by air, sea, rail or land.**

It would make sense for Vietnam to consider bringing its practice into conformity with the approach used by many other parties to the New York Convention.

The New York Convention states that " Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of arbitration." (Article II:1.) It also states that "Each Contracting State shall recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon, under the conditions laid down in the following articles." (Article III). It requires a party seeking enforcement to provide an authenticated original award and the original agreement to arbitrate. (Article IV)

Enforcement of an award is not required in all circumstances. Article V provides:

1. Recognition an enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that part furnished to the competent authority where the recognition and enforcement are sought, proof that;

(a) The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or

(b) The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or

(c) *The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration,* provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or

(d) The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or

(e) The award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.

2. Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:

(a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or

(b) *The recognition or enforcement of the award would be contrary to the public policy of that country."*

It is notable that most of the grounds for non-enforcement are procedural. The principal substantive grounds are those in Paragraph 1(a) or 2(b), shown in italics. However, most parties to the New York Convention, including the United States, have construed these and other exceptions to enforcement very narrowly.

C. **United States - Vietnam Bilateral Trade Agreement, Part IV**

With the exception of certain restrictions on performance requirements, there are no effective investment provisions in the WTO agreements. Chapter IV **incorporates** some of the NAFTA Chapter 11 provisions, and provisions of more than forty bilateral investment treaties ("BITs") that the United States has concluded with developing nations over the past 20 years. Chapter IV of the VBTA contains many of the provisions found in typical BITs, but is more limited in the terms of the level of protection of foreign investors in the territory of the other party. For example, it defines "investment" relatively broadly and includes the requirements of national treatment, most-favored-nation treatment, and fair and equitable treatment/full protection and security. (Articles 1, 2, and 3.) **Also, Chapter IV provides little procedural guidance on how the arbitration is to be conducted, leaving such issues to the relevant arbitration rules.**

Chapter IV **defines "investment" in the usual broad BIT manner. "National" is defined as a natural person who is the national of a party under its applicable law (Art. 10). Like most BITs, the VBTA does not by its terms bar dual nationals (e.g., Viet-kieu) from the jurisdiction of tribunals created under Chapter IV.**

Chapter IV also contains the usual national treatment and most favored nation protections (Art. 2). It incorporates the NAFTA/BIT requirement of fair and equitable treatment and full protection and security (Art. 3), a transparency obligation (Art. 5), and an obligation to permit a firm to choose its own top management without regard to their nationality (Art. 8.) Unlike NAFTA and many BITs, coverage of Chapter IV applies to existing as well as new investments (Art. 14).

The typical BIT requirement of unrestricted transfers and convertibility of profits and assets appears not in Chapter IV but in Chapter VII, and provides for MFN or national treatment with regard to such transfers.

Chapter IV imposes a limitation on required technology transfer, except under the requirements of environmental laws or competition laws (Art. 7). This presumably reflects long-standing U.S. and U.S. industry concerns regarding government mandated technology transfers as a condition of approving investments.

The expropriation provisions of Chapter IV (Art. 10) are substantively similar to those found in NAFTA (Art. 1110) and many BITs. They cover not only direct takings but also indirect measures that are "tantamount to nationalization or expropriation**."** The latter, under customary international law, refers to substantial interference with a private firm's control over the enterprise, or its expectations of the benefits of its investment. Compensation at fair market value is also required. In *Metalclad v. Mexico*, for example, the Tribunal appointed under NAFTA found that Mexican and local government actions blocking the operation of a hazardous waste facility constituted an indirect expropriation requiring compensation. This finding was made even though the government did not take physical possession of the property.

Also, the investor has the right to submit disputes with the host country to binding arbitration under the UNCITRAL Arbitration Rules, the Rules of the World Bank's International Center for the Settlement of Investment Disputes ("ICSID") or the ICSID "Additional Facility" Rules, which apply if the investor's home country and the host country are not both parties to the ICSID. The agreement **also** constitutes Vietnam's prior consent to such arbitration.

The reference to TRIMs in Article 11 prevents the Parties from imposing certain performance requirements that conflict with GATT national treatment requirements or quota prohibitions, such as limiting use of imported components to the volume of exports of final products, or local content requirements. (Annex I of the VBTA restates the TRIMs annex.)

As in NAFTA Annexes I and II, Annex H of the VBTA lists the sectors which are exempt from the obligations of Chapter IV, or where there are foreign ownership limitations, such as a 30% equity limitation for U.S. nationals. This will be an investment-limiting factor, as many U.S. firms do not invest abroad unless they can own a majority (51%) of the shares of an enterprise.

Procedurally, the VBTA provides binding consent by the governments to arbitration, and satisfies the "writing" requirement of the New York Convention and the jurisdictional requirement of ICSID. (Article 4:4) The usual alternative fora, ICSID, ICSID Additional Facility, UNCITRAL rules or any other mutually agreed rules, are set out. Since Vietnam is not yet a party to the ICSID Convention, that option is not available for resolving investment disputes under the VBTA. There is no requirement of exhaustion of local remedies, but an investor is limited to injunctive relief not including damages once international arbitration has been sought. (Article 4:3(B).)

There will be some advantages to Vietnam in negotiating a BIT with the United States in the future, as anticipated in Art. IV(13), based on the new 2004 Model BIT. That version of the BIT makes it **somewhat more** difficult for a private investor to make a successful expropriation claim for expropriation based on a regulatory taking, particularly regulatory action for environmental or health and safety reasons.

D. Vietnam – Korea Bilateral Investment Treaty

Like most other modern BITs, the Korea BIT defines "investment" broadly, to include "every kind of asset invested by an investor of one Contracting Party in the Territory of the other Contracting Party . . .." (Art. 1.) It accords fair and equitable treatment to investments (Art. 2(2)), and both national treatment and most-favored-nation treatment not only to "investment but to "returns," that is, profits, interest, capital gains, dividends and fees derived from the investments. (Arts. 1(3), 3(1)) The BIT also provides freedom of management choice (with some limitations, Art. 3); compensation for war losses (Art. 4); and compensation in the event of expropriation or equivalent measures, plus the right to recourse in national courts (Art. 5). Payments transfers by investors outside the country are also guaranteed. (Art. 6). **As with Chapter IV of the VBTA, there is no explicit ban to jurisdiction over dual nationals.**

As in many BITs, the investor has a choice of submitting a dispute to local courts, any applicable procedures previously agreed to, or to international arbitration. (Art. 8.) If arbitration is chosen, the investor has the usual three options, ICSID, ICSID Additional Facility, and UNCITRAL Rules. (Art. 9(4).) The BIT contemplates the standard three-arbitrator process; if there is no agreement on arbitrators, the Secretary-General of ICSID acts as the appointing authority. (Art. 11) Arbitration may be in any country that is party to the New York Convention. (Art. 13) The governing law is "this agreement and the applicable rules and principles of international law." (Art. 15)

Awards, once rendered, are enforceable if no party has sought annulment either through the Annulment Committee (under ICSID) or in a national court (under the AF or UNCITRAL Rules). (Art. 16(7).)

The BIT was concluded in September 2003, **and has entered into force**.

E. Vietnam – Japan BIT

The Japan BIT is similar to the Korea BIT in most substantive respects. It requires that investors be afforded national treatment and most favored nation treatment (Art. 2), and equal access to courts and administrative agencies (Art. 3). It bars most performance requirements, subject to some exceptions. (Arts. 4-6.) Rules and regulations must be published. (Art. 7) Fair and equitable treatment and full protection and security are required (Art. 9), and expropriation without "prompt, adequate and effective" compensation is barred. (Art. 9) War damage claims must be compensated on a national treatment, most favored nation treatment basis. (Art. 10) In most instances, free transfers of capital are required. (Art. 12.) In the event of disputes, if not resolved through consultation, the investor may seek arbitration under the ICSID, the ICSID Additional Facility, or the UNCITRAL Rules. (Art. 14) However, arbitration is not available if the case has been resolved by the national courts, or is subject to resolution with previously agreed upon procedures.

The BIT was concluded in November 2003; it has been ratified by both governments but has not yet entered into force.

III. The Major Arbitral Rules

This section concentrates on highlighting the *major* differences between the ICSID Additional Facility and the UNCTRAL rules, because those are the two options open to Vietnam under most BITs and the VBTA at the present time. However, some comments on the ICSID Rules are appropriate, because it is assumed that at some time in the future Vietnam will become a party to ICSID. Further comments on the different rules are discussed in Part IV, below.

In general, the operations of the rules are quite similar, in terms of coverage and the arbitral process itself. However, there are differences, which are important in some cases. Perhaps the most significant difference between arbitration under the two ICSID options, and under UNCITRAL, is the fact that ICSID arbitrations are managed by a knowledgeable secretariat as part of the World Bank, while the UNCTAD rules are *ad hoc*, in that there is no secretariat. When arbitration takes place under UNCTAD rules, a secretariat must be designated or created. This may be either an advantage or disadvantage, depending on one's point of view. Some attorneys representing private investors prefer the UNCTAD rules, because there is no secretary "looking over my shoulder" or second-guessing the attorney regarding whether the notice of arbitration is legally sufficient. On the other hand, there is the potential of additional delays if the investor and host state must agree on a secretariat to conduct an arbitration that the host state would likely wish to avoid entirely. At the other end of the process, the ICSID precludes appeals to domestic courts in the seat of the Arbitration; only the internal ICSID Annulment Committee permits any review.

It is also important to keep in mind that the parties to a BIT, the VBTA, Chapter IV, or NAFTA, have likely modified **to some extent t**he default rules in one of the arbitral systems. The definition of "national" may be less restrictive than in Article 25 of ICSID, which explicitly bars dual nationals. The tribunals may be required to accept direction from the parties to the agreement, as in Article 1131(2) of NAFTA which permits the Commission to issue binding rulings on issues of law to tribunals sitting in accordance with Chapter 11. Moreover, it isn't entirely clear that where the BIT or particular agreement **differs from the ICSID rules, the former will always prevail, although that is often the assumption**. **More likely, the Convention would prevail.**

Finally, in most instances, it is the foreign investor, not the government, who will choose among the three main options—ISCID, Additional Facility or UNCITRAL. (See NAFTA, Art. 1120(1), VBTA, Chapter IV, Art. 4(3)(a), Korea BIT, Art. 9(4).). Of course, the parties may discuss and reach agreement on one of these three alternatives, or any other that may be mutually acceptable.

A. ICSID Convention and Arbitral Rules

Arbitration under ICSID is a self-contained procedure. It is governed by two legal instruments, the ICSID Convention and the ICSID Arbitral Rules. They must be read together as well as in accordance with the BIT or other investment agreements that constitute the agreement by the government to arbitration investment disputes under the circumstances set out in the agreement.

Perhaps the most important aspect of ICSID arbitration is the high degree of structure. It is not only governed by the provisions of the ICSID Convention, but carefully managed by the ICSID secretariat. This is particularly important with regard to review of the request for arbitration by the Secretary General. He must register the request "unless he finds, on the basis of the information contained in the request unless he finds, on the basis of the information contained in the request, that the dispute is manifestly outside the jurisdiction of the Centre." (Art. 36(3).) Such jurisdiction is based on the ISCID Convention and on the provisions of the applicable investment agreement. Thus, registration is *not* automatic, and in some instances may be delayed or even refused, **such as when the investor is a dual national or if the dispute, in the view of the Secretary-General, is not a legal dispute arising out of an investment (Art. 25(1) and 25(2)).** (A question may arise as to whether the Secretary-General, despite some questions as to jurisdiction, should refuse registration or leave the jurisdictional issues to the tribunal. In many instances the latter course is followed.)

The Secretary-General also has considerable control over the choice of members of the tribunal. Normally, each party to the dispute appoints one arbitrator, and the parties decide on a chairperson. (Art. 37(2)(B).) However, if one party fails to appoint its arbitrator, or if there is no agreement on the chairperson—as is very often the case—the Secretary-General is to appoint the missing arbitrators (who may not be nationals of either of the parties). (Art. 38).

The Convention and Arbitral Rules also provide detailed procedural rules for such issues as hearings, language, memorials, confidentiality, costs of the proceeding, etc. The fees for use of ICSID facilities (**$15,000 minimum for registration)**, and for payment of arbitrators ($2400/day) are also specified, although the latter is subject to negotiation.

The third major aspect of ICSID arbitration arises if one of the parties (often the host state) wishes to challenge the award, to have it annulled. Under ICSID, this can be done only internally, through the request for an Annulment Committee (Arts. 50-55); there is no recourse to domestic courts in the seat of the arbitration, as under the AF or UNCITRAL rules. Whether the Annulment Committee is an advantage or disadvantage over the courts of the seat of the arbitration is a matter of some dispute among international arbitration experts.

B. ICSID Additional Facility

The AF was created to facilitate the use of the extensive ICSID facilities in situations where either the host state or the foreign investor's state is not an ICSID party. Since one or the other will not be an ICSID party, the Convention itself is inapplicable. Arbitration under the AF is thus governed by the AF rules and the investment agreement. The AF rules are thus broader than the ICSID Arbitration Rules alone, **in the sense that they are self-contained**. *However, if both affected nations—the investor's and the host-- are parties to the ICSID Convention, **and the dispute is within the jurisdiction of the Convention**, the AF Rules are not available.*

The similarities to ISCID arbitration are, nevertheless, **probably** greater than the differences. For example, the Secretary-General must still determine of the request for arbitration meets the requirements of the AD Rules, although the "manifestly outside the jurisdiction" language of the ICSID Convention does not exist. (See Art. 3) **Also, matters that do not meet the jurisdictional requirements of ICSID may in some circumstances be arbitrable under the Additional Facility Rules.** In general, the AF rules for requests are more form that substance, so there are probably fewer instances in which refusal to register is likely to be an issue. The Secretary-General is also responsible for appointment of arbitrators if the parties fail to agree. Each party is to nominate two arbitrators, one as a party arbitrator and the other as chairperson (who most all be non-nationals **unless the investment agreement indicates otherwise, as with NAFTA**), and the Secretary-General selects from those nominated if possible. (Art. 9) If there is no agreement on the chairman—as in **many** cases—either party may request the Secretary-General to make the nomination, who then does so "promptly" in consultation with the parties. (Art. 10)

There is no recourse to the ICSID Annulment Committee for awards rendered under the AF Rules (or the UNCITRAL Rules). However, in most instances, recourse may nevertheless be had to the courts of the seat of the arbitration **under applicable provisions of the law of that jurisdiction.**

(The AF Rules, like the AF Rules, are not a treaty, and thus do not supersede national law in the place of arbitration.)

C. UNCITRAL Rules

As noted earlier, the most significant aspect of the UNCITRAL Arbitration Rules are that they are just that—rules, but no secretariat or other institutional backup. **Arbitration under the UNCITRAL Rules** is essentially a bilateral process. They may be preferred by some developing country governments because they were adopted in 1976 by the United Nations General Assembly, a body in which developing nations have effective control. However, the lack of a specified secretariat may ultimately work to the disadvantage of the host state, although it is probably better than a totally *ad hoc* proceeding. (If it is the objective of the host state to delay the proceeding, in contrast, the UNCITAL rules may prove advantageous, as it may take at least several months for the Permanent Court of Arbitration to designate an Appointing Authority, and for the Appointing Authority to designate the chairperson or other arbitrators.) Also, **under** the UNCITRAL Rules, **the law of the state of the place of arbitration governs the possible review of arbitral awards rendered in that state by its national courts. This is contemplated by the UNCITRAL Rules, which provide that "These Rules shall govern the arbitration except that were any of these Rules is in conflict with a provision of the law applicable to the arbitration from which the parties cannot derogate, that provision shall prevail." (Art. 1(1))**

Under the UNCITRAL Rules, no one reviews the notice of arbitration for content, or to determine whether jurisdictional requirements are met, as with the ICSID alternatives. Rather, a notice in proper form is simply sent by the initiating party to the respondent state; it is solely a bilateral process, without the intervention of a third party. (Art. 3) If the parties cannot agree on the members of the tribunal, the Appointing Authority designated by the parties (often in the BIT or other agreement; in NAFTA, for example, even when arbitration is under UNCITRAL, the ICSID Secretary-General is the appointing authority, Art. 1124, but many BITs do not specify). If none has been designated, the Secretary-General of the Permanent Court of Arbitration is to designate the Appointing Authority
(not to serve as the appointing authority itself.) (Art. 6(2).)

The secretariat may be totally *ad hoc*, a law firm as with *S.D. Myers v. Canada*, or an existing entity, such as the London Court of International Arbitration (*OEPC v. Ecuador*), **the Singapore Arbitration Centre, etc. The ICSID Secretary – General has also agreed to provide administrative services for several NAFTA arbitrations conducted under the UNCITRAL Rules.**

IV. **Preliminary and Procedural Issues**

A. Scope of "Investment"

A major issue not only under NAFTA but also under many BITs is the scope of the term "investment." The tendency today is to define the concept very broadly. In the Korea BIT, for example, it includes movable and immovable property; shares of stocks or bonds; claims to money; intellectual property rights; rights conferred by laws under investment contracts. (Art. 1(1))) The VBTA includes all of these, tangible or intangible property and explicitly "a company or enterprise." (Art. IV(1)(1)(A).) The Japan BIT has similar coverage.

These provisions go well beyond the traditional international law of tangible property that can be "taken" or "expropriated" by government action. In the NAFTA context for example, the requirement of "investment" had been determined by tribunals to include the rights of a Canadian company that is a subsidiary of a U.S. company to export lumber (*Pope & Talbot v. Canada*); the right of a Canadian subsidiary of a U.S. company to arrange for the exportation of hazardous waste (*S.D. Myers v. Canada*); and the right of a Mexican company owned by an American citizen to export cigarettes and alcoholic beverages (*Feldman v. Mexico*). The many new ICSID cases against Argentina will likely face challenges to jurisdiction based on the lack of an "investment" and most will probably lose on this issue, although whether the Argentine government violated the provisions of the BITs with the United States, Spain and Italy is a more difficult question.

B. Measures By Reason of or "Arising out of" the Investment

In the Japan BIT, "investment dispute" is defined as "a dispute between a Contracting Party and an investor of another Party that has incurred loss of *damage by reason of, or arising out of*, and alleged breach of any right conferred by this Agreement . . .." (Art. 14(1)) The Korean BIT contains similar "by reason of or arising out of, that breach." (Art. 9(1)) The VBTA states that an "investment dispute" is "a dispute . . . arising out of or relating to an investment authorization, and investment agreement or an alleged breach of any right conferred, created or recognized by this Chapter . . .." (Art. IV(1)(10). (NAFTA contains the language "relating to" investors and investments in Art. 1101, and "by reason or arising out of" in Arts. 1116 and 1117.) Thus, in each case **there may be** an issue as to whether the alleged loss or dispute was by reason of or arising out of a breach of the BIT.

These requirements are also found in the arbitral rules. For example, in the UNCITRAL rules, the notice of arbitration must include, *inter alia*, "a reference to the contract out of or in relation to which the dispute arises." (Art. 3(2)(d).) In the ICSID Convention, the jurisdiction of the Centre "shall extend to any legal dispute *arising directly* out of an investment . . .." (Art. 25(1). The use of the term "directly" arguably results in a stricter standard that the BIT "by reason of arising out of" language. There is no such language in the AF Rules.

In many instances under the BIT language, for example, a direct expropriation where the government physically takes over the property of the foreign investor, no issue will arise. However, some government measures are more indirect. For example, is action by the State of California to ban the use of a gasoline additive MTBE a measure sufficiently "relating to" a foreign producer, not of MTBE, but of methanol, the primary ingredient of MTBE? The tribunal in *Methanex v. United States*, essentially decided that the California measures did not constitute "a legally significant connection between the US measures, Methanex and its investments." Accordingly, it decided that it did not, based on the facts alleged by Methanex, have jurisdiction over the case based on the facts then before it. (Proceedings are continuing based on new submissions.) Among the considerations apparently important to the tribunal were the absence of any expressions of intent by the California governor to affect methanol suppliers, and the fact that the ban was purportedly based on air quality and other public health related reasons.

C. Nationality and Dual Nationality.

Perhaps surprisingly, most BITs do not deal **explicitly** with the concept of dual nationals. There do not appear to have been many investment cases in which dual national issues have arisen, even though, for example, there are many U.S. and Canadian citizens—among other nations-- who are dual nationals (e.g., U.S. – Vietnam, U.S. – Mexico, Canada – India). Most BITs (and NAFTA) **do not deal explicitly with questions of dual nationality**. Thus, Article VI(1)(9) of the VBTA defines national as "a natural person who is a national of a Party under its applicable law." Article 1(1)(a) of the Vietnam – Japan BIT defines "investor" as a "natural person having the nationality of that Contracting Party in accordance with its applicable laws and regulations . . .." In the Vietnam – Korea BIT, the term "natural person" is defined in a similar matter.

In fact, only the ICSID Convention, Article 25(2)(a), effectively resolves this issue, by defining the term "national of another Contracting State" as a "natural person who has the nationality of a Contracting State, other than the state party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration . . . *but does not include any person who on either date also had the nationality of the Contracting State party to the dispute* . . . ." Thus, the Convention definition of "national" bars dual nationals from the Centre's jurisdiction unless arbitration is sought under a BIT that does not bar dual nationals, and unless the BIT provision overrides Article 25(2)(a), which is doubtful. **Since this language has been known to all parties negotiating BITs, it must be assumed that the failures to incorporate the ICSID limitations to (dual) nationality were intentional.**

If Vietnam became a party to ICSID and a U.S./Vietnamese dual national were to seek protection of VBTA Chapter IV, which has a less restrictive definition of "national", it seems likely that the Convention would be controlling, and jurisdiction would be denied. The Secretary-General would likely refuse to register the case. However, the dual national might well try to avoid the problem by renouncing his Vietnamese citizenship after the dispute arose but before any filings with ICSID. More likely, the investor would choose the UNCTRAL Rules, which like the Additional Facility Rules leaves the issue of nationality to the underlying investment agreement.

The fact that dual nationals are not explicitly barred from arbitral jurisdiction under the relevant BITs, in general, does not necessarily mean that the tribunal would accept jurisdiction in all instances. Some might decide to apply general principles of international law to the question. Under international law generally, a national investor does not have rights to diplomatic protection by the home state unless he is a national of that state. Generally, one state cannot exercise the right of diplomatic protection on behalf of a person who is a national of the state in which the investment dispute occurs. Where there is a question under international law of more than one nationality, the concept of "effective nationality" **might well** be applied, where the closer connections (between the two states) would likely govern. Any late acquisition of nationality may be rejected (e.g., the *Nottebaum* case), particularly where the nationality of the protecting state is acquired for the purpose of seeking diplomatic protection or rights under a BIT. **(In the recent case of *Hussein Nuaman Soufraki v. United Arab Emirates*, a person who had lost his Italian citizenship (by obtaining Canadian citizenship) was barred from arbitration under the provisions of the Italy – UAE BIT.)**

There is also a colorable argument that person who maintains bonds and benefits of nationality with both states should not be able to utilize BIT dispute settlement provisions, but I am unaware of any case to that effect. **This argument could be weakened if the host state, as in the case of Vietnam, establishes special programs to attract investment from overseas nationals.**

However, international law restricting the right of a home state to assert diplomatic protection against a second state on behalf of a dual national has been blurred by practice in recent years, **and the effective nationality concept may no longer be considered to be customary international law.** The United States, for example, asserted that right over many naturalized U.S. citizens who remained citizens of such countries as the former Yugoslavia, because at the time Yugoslavia refused to recognize a renunciation of citizenship. Similarly, under the Helms-Burton legislation passed regarding Cuba in 1996, naturalized Cuban citizens are given rights against Cuba to pursue claims for expropriated property, even though diplomatic protection would have been barred under traditional international law principles because at the time of the takings the individuals were citizens of Cuba, not the United States. In those instances, in particular, a demonstration that the Claimant is a national of the protecting state could end the discussion, at least where arbitration is sought under the AF or UNCITRAL rules.

In most instances of investor – state disputes under Chapter IV of the VBTA, jurisdiction would likely extend to dual nationals (Viet-kieu). The definition of "national" in Chapter IV is silent on the issue of dual nationals, as noted earlier, and there is no provision of the VBTA that would otherwise bar dual nationals from its benefits and obligations. Moreover, the negotiating history of the VBTA makes it abundantly clear that Viet-kieu are covered. We understand that the issue of coverage of Viet-kieu was discussed at very high levels of the U.S. and Vietnamese governments during the negotiations, and resolved in favor of full coverage.

Of course, the Chapter IV provisions are full reciprocal. It is thus possible that a Viet-kieu could seek the protection of Chapter IV in a dispute arising out of an investment in the United States, although this is probably much less likely that an action by a Viet-kieu under the VBTA to challenge in arbitration an action of the Vietnamese Government as a violation of Chapter IV.

In one NAFTA Case, *Feldman v. Mexico*, the tribunal determined in a preliminary opinion that a person who was a citizen of the United States, but also a permanent resident (for many years) of Mexico, was not a "national" of Mexico so as to preclude the tribunal's jurisdiction over the dispute.) (In NAFTA, there is jurisdiction over both nationals and permanent residents, presumably so that a third country national that has acquired residency in one of the NAFTA countries can avail herself of the benefits of Chapter 11 even though she is not yet a citizen.) **The *Feldman* tribunal briefly discussed the "effective nationality" principle before rejecting it as inapplicable, because the Mexican Government raised the issue in its memorials.**

Nationality issues may arise with regard to corporate persons as well. Many years ago, the International Court of Justice, in *Barcelona Traction,* determined that only the Government of Canada (where the company was incorporated), not the Government of Belgium (where most of the shareholders were citizens) could act on behalf of the corporation's interests in an investment dispute with Spain. Modern BITs at least in part overrule this determination. Most BITs deal with the issue by defining "investor" and "investment" and "company" broadly. For example, under the Vietnam – Japanese BIT, an "investor" under Article 1(1)(b) is "a legal person or any other entity constituted or organized under the applicable laws and regulations of the Contracting Party . . . ." and "investment" (Article 1(1)(2)(b)" includes shares, stocks or other forms of equity participation in an enterprise . . . ." This means that, for example, if a Japanese corporation owns shares in a Vietnamese company—including minority ownership rights— or citizens own shares in the host country indirectly-- they are covered under the BIT. (Some third country corporate ownership interests nevertheless may not be covered.) However, in many instances, including NAFTA, a third country corporation does not benefit from the treaty provisions unless it has a substantial presence in the treaty country in which it seeks status as a Claimant. **The Vietnam – Netherlands BIT explicitly deals with the *Barcelona Traction* problem by including in the definition of nationals " "legal persons not constituted under the law of that Contracting Party but controlled, directly or indirectly, by natural persons…" having the nationality of the party to the BIT. (Art. 1(b)(iii))**

One other NAFTA decision **may have some relevance by analogy to dual national issues. In** *Loewen v. United States*, the tribunal rejected a claim originally brought by a Canadian corporation, after the Canadian company was acquired (in bankruptcy) by a U.S. company, and in the view of the tribunal became a claim of a U.S. national. The tribunal stated:

> Chapter Eleven of NAFTA represents a progressive development in international law whereby the individual investor may make a claim on its own behalf and submit the claim to international arbitration, as TLGI has done in the instant case. *The format of NAFTA is clearly intended to protect the investors of one Contracting Party against unfair practices occurring in one of the other Contracting Parties. It was not intended to and could not affect the rights of American investors in relation to practices of the United States that adversely affect such American investors.* Claims of that nature can only be pursued under domestic law and it is inconceivable that sovereign nations would negotiate treaties to supplement or modify domestic law as it applies to their own residents. Such a collateral effect on the

> domestic laws of the NAFTA Parties was clearly not within their contemplation when the treaty was negotiated. (Emphasis added.)

In a very recent ICSID Case, *Tokios Tokeles v. Ukraine*, a majority of the panel decided that there was ICSID jurisdiction over a dispute between a Lithuanian corporation and the Government of the Ukraine, even though virtually all of the shares of the corporation were owned by Ukrainian nationals. The President of the panel filed a highly unusual and strong dissent, arguing that this acceptance of form—Article 25 bars dual nationals who are natural persons from such jurisdiction but is silent on corporate entities—over substance frustrates the objective and purpose of the limitation in Article 25. The panel assumed that while a BIT could establish narrower jurisdiction than the Convention, it could not provide broader jurisdiction, e.g., permit dual nationals to bring actions against their own governments. The case will almost certainly be submitted to the ICSID Annulment Committee.

D. Counter-Claims and Defenses

It is not **unknown** for a host state, in an arbitration, to assert that the relief sought by the investor should be denied by the tribunal because the investor had been involved in illegal activity in the host state. In the absence of a court proceeding against the investor, conducted under national law and in circumstances where the national courts or administrative agencies determining the illegality are independent of the executive branch and operate with a full measure of procedural due process, it is difficult for host states to prevail on these issues. The strongest case for the host state probably exists when the dispute is over a contract or concession agreement with the government, and the events of breach by the investor which permit termination of the contract are clearly defined in the contract. It is also notable that most BITs do not discuss counterclaims at all.

In *Amoco v. Indonesia*, the Indonesian government argued in a counter-claim that Amoco had committed tax fraud. The tribunal refused to consider the allegations. There was no coverage of such matters in the investment agreement, and the tribunal did not consider that the tax allegation was a matter “arising out of the investment” under Article 25(1) of the ICSID Convention. It further decided that “the obligation not to engage in tax fraud is clearly a general obligation of law in Indonesia." The claim of tax fraud was thus beyond the tribunal’s competence.

Allegations of misdeeds also arose in *Feldman v. Mexico*. During the arbitral proceeding, Feldman and the Mexican tax authorities were also in litigation in Mexican courts, with the tax authorities demanding refunds of certain tax rebates Feldman had paid. (These were civil, not criminal, actions, but taxation issues were central to Feldman’s claims.) They were not finally resolved during the course of the arbitration. The fact that an American citizen, Feldman, had been audited regarding these taxes, but a Mexican group that had received similar rebates was not being challenged, was one of the factors that led a majority of the tribunal to conclude that Feldman was not receiving national treatment. During the hearing, Mexican authorities also alleged that Feldman was part of a scheme to export Mexican cigarettes, and to illegally re-import them without paying the 85% excise tax on cigarettes. However, the evidence presented to the tribunal was incomplete, and Mexico had brought no national court actions, civil or criminal, against Feldman based on the allegations, so the tribunal did not give any significant weight to them.

Somewhat similar but equally troubling questions arise where evidence is presented to the tribunal that indicates that the investment contract or concession now under dispute was obtained through bribery of host government officials. Under the laws of almost all countries, such corruption is illegal, and is likely grounds for annulling the contract, even if in practice bribery is common and the laws are not regularly enforced. If the foreign investor has been tried and convicted of bribery in the host country, or whether local courts have under authority of local law terminated the contract, these decisions would undoubtedly be given weight by the arbitrators. **A similar issue might arise if the investor had been charged and convicted of customs fraud. However, a tribunal might find it difficult to dismiss an international arbitration on this ground in a country where customs fraud (through bribing of customs officials) is a way of life, and is prosecuted only on a selective basis, if at all.**

However, while there well may be a growing view in the international community that contracts obtained by bribery are invalid and should not be given effect either by courts or by arbitral tribunals, it is questionable whether this view has attained the status of customary international law. (The World Bank and other development banks are among those institutions, which effectively follow this line of reasoning.) There are OECD, Organization of American State and now a U.N. convention on bribery, but the latter at least has not been widely ratified. Moreover, defining illegal action itself is difficult. Payments for the personal use of an official are probably easy to categorize; what about contributions for a re-election campaign, or to meet other pressing needs of the government?

The issue arises in *World Duty Free Company v. Kenya*, now before ICSID. Apparently, the Claimant initially bribed the president of Kenya in order to obtain permission to set up duty free shops in the local airports. Kenya is now arguing that as a result of the bribery the contract underlying the ICSID dispute is void or voidable and thus not enforceable. The result may well depend on the strength of the evidence of corruption, Kenya law provisions regarding contracts obtained by bribery, and whether a majority of the arbitrators believe there are any **customary** international law rules governing such situations.

E. Choice of Forum

In most BITs and the VBTA, the investor (not the host state) has the right to choose to submit the dispute to any of the alternative fora available under the agreement. In the Korea BIT, the investor initially chooses among local courts, a previously agreement mechanism, or arbitration under one of the usual thee sets of rules. (In effect, there are only two arbitral choices. UNCITRAL Rules are always an option. If both affected nations are parties to ICSID, the Additional Facility rules are not available, **unless the dispute is outside the jurisdiction of the Convention**. If only one is party to ICSID, the ICSID Rules are not available.) The VBTA **choices** are similar, adding any other mechanism agreed to by the parties.

The Japan BIT, although worded differently, essentially requires the investor to choose between local courts, previously agreed procedures or arbitration, although only a final local court decision definitively appears to bar arbitration. (Art. 14(6).)

These agreements raise the question of what happens if the investor **first refers the dispute to** the local courts, and then decides to seek arbitration? This so-called "fork in the road" problem is better articulated in other BITS. For example, in Art. IX(3)(a), the 1994 U.S. Model BIT, submission of a dispute to arbitration is permitted only "provided that the national or company concerned has not submitted the disputes for resolution under paragraph 2(a) [national courts or administrative tribunals] or (b) [previously agreed dispute settlement procedures].

In many arbitral proceedings where investors have resorted in some form or another of national court action, the host state seeks to bar arbitration on that ground. The wording of the BITs suggests that in fact the investor must choose and, having made a choice, not seek the arbitration alternative. This is the strong implication of the VBTA, since there is an explicit exception to the choice of arbitration over local courts for "interim injunctive relief, not involving the payment of damages . . .." (Art. IV(4)(3)(b))

However, tribunals have been very reluctant to dismiss cases based on fork in the road considerations. In most instances, they have refused to enforce such choices in cases where the plaintiffs and the issues the national litigation are not identical to the investors seeking international arbitration. (See *Ronald S. Lauder and The Czech Republic; Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil and the Republic of Estonia; OEPC v. Ecuador.* Also, where the investor in the national arbitration did not explicitly raise alleged violations of the BIT **in the local courts**, this has been cited as a ground for permitting the arbitration to go forward. Thus, in *CMS Gas Transmission Company and The Republic of Argentina,* the tribunal noted:

> Decisions of several ICSID tribunals have held that as contractual claims are different from treaty claims, even if there had been recourse to the local courts for breach of contract, this would not have prevented submission of the treaty claims to arbitration. This Tribunal is persuaded that with even more reason this view applies to the instant dispute, since no submission has been made by CMS to local courts and since, even if TGN had done so– which is not the case–, this would not result in triggering the 'fork in the road' provision against CMS. *Both the parties and the causes of action under separate instruments are different.*

Thus, there is some doubt as to whether the apparently required choice is in fact mandatory, **or enforceable as a ban to jurisdiction**.

F. Notice and Initiation of Arbitration

Virtually all BITs with international arbitration provisions have specific requirements obligating the foreign investor to notify the host state of the investor's intent to seek arbitration. Most of these are procedural. **They** include, in the UNCITRAL Rules, a demand for arbitration; names and addresses of the parties; reference to the applicable arbitration clause or agreement; reference to the contract under which the dispute arises out of or relates to; relief sought; proposal on the number of arbitrators. (Art. 3(3).) The AF rules are similar generally but less precise, and as noted earlier do hot have the arising out or relating to language. (Art. 3) The ICSID Convention states only that "The request shall contain information concerning the issues in dispute, the identity of the parties and their consent to arbitration in accordance with the rules of procedure for the institution of conciliation and arbitration proceedings." (Art. 36(2)) However, as noted earlier, the ICSID request must also meet the "arising directly" requirement of ICSID Convention, Art. 25(1).

In practice, initiation is virtually automatic under the UNCITRAL Rules because "Arbitration proceedings shall be deemed to commence on the date on which the notice of arbitration is received by the respondent." (Art. 3(2).) **Normally, the request would be delivered by courier or certified mail to the relevant ministry of the host government, with a signature and date establishing the fact of delivery.** If there are issues, for example, as to whether the measure alleged to violate the BIT "relates to" the investment, or any other defects in the notice, those will have to be resolved by the arbitral tribunal, since there is no secretariat or Secretary-General to screen the notice.

This contrasts with the situation under ICSID, where questions of compliance with Article 25 ("directly related" or dual nationality), **and with relevant provisions of the BIT under which the dispute is being submitted**, may be resolved by the Secretary-General by refusing to register the arbitration. There is also a registration question with the AF rules, since the request must be made by the investor to the Secretariat (Art. 2), and the request is registered "as soon as the Secretary-General shall have satisfied himself that the request conforms in form and substance to the provisions of Article 3 of these rules [designating the content of the request, but without any 'arising out of or relating to' language]."(Art. 4)

What does this mean in practice? Many private counsel prefer the UNCITRAL rules precisely because the ICSID Secretary-General cannot second-guess the sufficiency of the request for arbitration. If there is an issue, it will be resolved by the tribunal, at least one member of which will have been designated by the investor. In contrast, the ICSID rules are more favorable in this respect to the host government, as in cases where there is a significant issue, as of remoteness of the measure to the investor's interests, or evidence of dual nationality, the Secretary-General may delay or even refuse registration. The AF rules fall somewhere in between; the Secretary-General clearly may review the request for conformity with the rules, but such issues as whether the measure relates to the investor will be governed by the underlying BIT, as will questions of nationality, which means they will be decided—probably on a preliminary basis as in *Feldman v. Mexico,* rather than by the Secretary-General.

It is worth noting that the United States has recently been concerned that in some NAFTA cases the tribunals have joined some procedural and jurisdictional issues to the merits (e.g., in *Pope*

& Talbot), which results in longer and more expensive proceedings. Accordingly, in more recent FTA investment provisions (Chile, Singapore, and the Central American countries) there is **a** provision designed to strongly encourage tribunals to deal with such issues as preliminary matters, before reaching the merits. For a variety of reasons, tribunals seem to be reluctant to do this, just as they seem reluctant **more generally** to dismiss cases on jurisdictional or procedural grounds.

Other requirements for initiation include time requirements, e.g., evidence that three months have passed since consultation was initiated under Art. 14(3) of the Japan BIT; a consent to arbitration and waiver of rights to initiate national court action under Art. 9(6) of the Korea BIT, or, under NAFTA, Art. 1122, that the investor consents to arbitration and waives his right to initiate or continue any actions in the national courts. (Consent is automatic under Art. IV(4)(4) of the VBTA.)

G. Choice of Arbitrators; Appointing Authority

In most instances of international arbitration, three arbitrators are used, one each chosen by the parties, and the chairperson, chosen by agreement of the parties or, in the frequent absence of agreement, by the designated appointing authority. Most BITs provide for the alternative of a sole arbitrator, but this approach is seldom used by investors. Most likely, investors and governments alike feel more comfortable in a situation where each has chosen an arbitrator who while a person of high moral character and is believed to be sympathetic to one's own position, a person who hopefully will favorably influence the other arbitrators (particularly the President) and will exercise good judgment.

Both the Korea BIT and the Japan BIT explicitly contemplate the use of three arbitrators, unless the parties otherwise agree. (Arts. 13(2), 11(1), respectively.**)** The VBTA does not specify, but this does not really matter, since three arbitrators are the rule under ICSID (Convention, Art. 37(2)(b)), the AF Rules (Art. 6(1)), and the UNCITRAL Rules (Art. 5).

Normally, each party designates his own arbitrator, and the chairperson is to be chosen by agreement of the parties (or by the two arbitrators under the UNCITRAL Rules). This is provided either in the BIT, or in the arbitral rules. (See Art. 11(1) of the Korea BIT; UNCITRAL Rules, Art. 7). Under the ISCID Rules, each party proposes two arbitrators, one to serve as chairperson, with the hope that the parties will concur on the chairperson. (Rule 3). Under the UNCITRAL Rules there are not restrictions on the nationality of party-designated arbitrators. Under the ICSID, nationals of the parties are not to be appointed absent the consent of the other party (which may occur when both parties feel that one of their own nationals should be appointed). (Rule 1) (Article 7 of the AF Rules is similar.)

Agreement on party-appointed arbitrators is not unusual, but there is often disagreement on the chairperson or President, whether he is to be appointed by the parties or by the party-designated arbitrators. Under the ICSID Convention, if there is no agreement on the arbitrators within 90 days after dispatch of the notice of registration, the Secretary-General makes the missing appointments after consultation with the parties. (Art. 38.) This approach assures that the proceedings cannot **be**

significantly delayed by the inability of the parties to agree on arbitrators, as has happened in state-to-state arbitration under Chapter 20 of NAFTA. (In *Cross-Border Trucking Services* between the United States and Mexico, the governments required 15 months to agree on the five arbitrators.) **If the respondent government refuses to appoint its arbitrator, or otherwise participate in the proceedings, the constitution of the tribunal and the litigation of the case will nevertheless proceed expedititiously. The tribunal likely will continue to advise the respondent government at every succeeding stage of the proceedings, and invite its participation in all procedural decisions such as the selection of the chairperson and seat of the arbitration. This is in accordance with applicable arbitration rules that require notice and transparency, and to avoid later court challenge to the award.**

Under the AF Rules, unless specified otherwise in the BIT, if there is no agreement after 90 days, either party may request the ICSID Administrative Council to appoint the missing arbitrator or arbitrators. (Art. 6(4)) (NAFTA, for example, provides that the Secretary-General of ICSID is the Appointing Authority, regardless of whether the arbitration is under ICSID, the AF, or UNCITRAL Rules. NAFTA, Art. 1124(1).)

The situation is different under UNCITRAL, unless the Appointing Authority is specified in the BIT. There, if there is no agreement on arbitrators, as noted earlier, the Secretary-General of the Permanent Court of Arbitration at The Hague is to appoint the Appointing Authority. (Art. 7(2)(b).)

The qualifications for abitrators are usually not specified in much detail. For example, in Art. 8 of the AF rules, it is stated that "Arbitrators shall be persons of high moral character and recognized competence in the fields of law, commerce, industry or finance, who may be relied on to exercise independent judgment." There is no requirement that they be lawyers. It is obvious that there are potentially conflicts of interest, as arbitrators are *ad hoc* and part-time. Many are long-time experts in international investment law, and thus may have greater sympathies for foreign investors than for host governments. Choice of party arbitrators is thus a process that requires great care and knowledge of the views of the candidates.

H. Applicable Law

Choice of law may be one of the more difficult issues facing parties and tribunals. Most investors and their governments seek decisions based on international law principles of state responsibility for foreign nationals; if they were completely satisfied with national law and national courts there would be no reason for BITs or other investment agreements. Often, therefore, BITs contain references to international law, instead of or in addition to national law. For example, in the VBTA, the "general standard of treatment" requires treatment no "less favorable than that required by applicable rules of customary international law." (Art. IV(3))

The expropriation provisions are similar to those found in many BITs, covering direct and indirect expropriation and requiring the payment of prompt, adequate and effective compensation, in accordance with due process and the "general principles of treatment

provided for in Article 3," a cross reference to the requirements of customary international law. (Art. IV(10)(1)) The Japan BIT refers to "due process of law" but not to "international law." (Art. 9(2)), although the substantive definitions again recite the international law standard. The Korea BIT is similar. NAFTA states that issues are to be decided "in accordance with this Agreement and applicable rules of international law." (Art. 1131(1).) One provision unique to NAFTA is the right of the Parties, through the Commission, to issue "interpretations" which "shall be binding on a Tribunal established under this Section." (Art. 1131(2).) In most other BITs, the host state can of course present its views as to the applicable law, but those views have no binding effect.

However, national law also may be relevant. This is particularly true where there is an investment contract or investment agreement with the government upon which the dispute is based, and the contract provided that it is governed by local law. Also, the tribunal may have to review local law to determine whether a measure taken by the government rises to the level of a breach of the BIT. For example, in *OEPC v. Ecuador*, the issue was whether a change in local law which denied OEPC rebates of value added taxes which it had enjoyed in the past violated BIT provisions relating to national treatment, fair and equitable treatment and expropriation. Much of the opinion is devoted to analysis of OEPC's contract and to local tax law.

The arbitral rules may fill the gaps, at least partially. The UNCITRAL rules provide, where the agreement does not specify choice of law, that the tribunal "apply the law determined by the conflict of laws rules that it considers applicable." (Art. 33) This may well result in application of international law, since that is the body of law that most arbitrators are familiar with when investment disputes arise. The AF rules go further. In addition to referring to the application of conflicts of law rules, the tribunal may apply "such rules of international law as the Tribunal considers applicable." (Art. 54(1).) ICSID is similar; see Art. 42(1)). Thus, for proceedings under ICSID or the AF, applicability of international rules is explicit, but under the UNCITRAL rules they are arguably implicit.

In *Amoco v. Indonesia*, the tribunal suggested that even where there were relevant host-state laws that might be applicable under conflicts of laws principles, "they must be checked against international laws, which will prevail in the case of conflicts. Thus, international law is fully applicable . . .." It should be noted, however, that the precise content of "international law" or "customary international law" is not always clear. Despite arguments contra by the United States and Canada, NAFTA tribunals have opined that customary international law may be determined by reference to all relevant sources, including various BITs and international arbitral decisions, and that the customary international law of investment protection is an evolving concept. (See *ADF v. Canada, Mondev v. United States*.) Article 38 of the Statute of the International Court of Justice, which provides a hierarchy of international law sources, including treaties, custom, general principles, treatises and court/arbitral decisions, is also relevant.

Given the international nature of these proceedings, their operation under one or more treaties, and the international law expertise of most arbitrators, it is safe to assume that international law will be applied in most decisions, in addition to or in place of national law.

I. Costs of the Proceedings

Traditionally, one of the claimed advantages of arbitration was that it was speedier and less costly than court litigation, in part because document discovery rules were less extensive than in common law legal systems than in the United States. International arbitration is generally popular not for cost reasons, but because there are seldom any reasonable alternatives, as neither party is likely to be willing to submit disputes to the courts of the other parties.

Nevertheless, the costs of arbitration are significant, often several million dollars or more for the secretariat charges, fees to arbitrator and counsel fees. (These were over \$6 million in the NAFTA *Pope & Talbot* case.) ICSID fees are a minimum of \$15,000 and can be much higher, particularly if there are drawn-out proceedings and multiple hearings. ICSID arbitrators are usually paid at the rate of \$2400 per day (\$300 per hour), but may be negotiated upwards if arbitrators so demand. Travel expenses may be steep, as most of the arbitrators, the parties and counsel will have to travel to the hearings (usually in Washington, D.C. if ICSID is acting as secretariat). The parties may agree to hold hearings elsewhere, but travel costs are likely to be substantial regardless. Legal fees for major law firms who represent investors and host governments range from \$200 to \$500 per hour, but may be negotiable (downward).

From a cost point of view, multiple hearings are to be minimized, although if a separate hearing is held on preliminary and jurisdictional issues that may eliminate further proceedings and thus be cost-effective overall.

In most instances, the tribunal allocates the costs of the proceedings, including legal fees. Under the UNCITRAL rules, the tribunal "shall fix the cost of arbitration in its award." (Art. 38) These include the winning party's attorney's fees if those fees were claimed during the proceeding, and any fees of the appointing authority. With UNCTRAL, "the costs of arbitration shall in principle be borne by the unsuccessful party. However, the arbitral tribunal may apportion each of the costs between the parties if it determines that apportionment is reasonable, taking into account the circumstances of the case." (Art 40) The UCITRAL tribunal has similar flexibility with regard to legal fees.

The ISCID rules provide for costs to be apportioned as directed by the tribunal (Rule 28) but are silent on attorneys' fees. Under the AF rules, unless the parties decide otherwise, both the secretariat costs and the expenses of the parties (presumably including travel and counsel fees) are apportioned by the tribunal. (Art. 57.)

In practice, apportionment of costs depends on whether one party "wins" and another "loses". For example, in the NAFTA *Pope & Talbot* case, under the UNCITRAL Rules, the tribunal considered that the company won on some issues (violation of fair and equitable treatment) but Canada prevailed on claims of violations of national treatment, performance requirements and expropriation. The tribunal also felt that a series of "novel" issues had been raised in this early

Chapter 11 case. Thus, most of the costs were split evenly, and the parties paid their own attorneys' fees. Exceptions to the equal division of costs were made for two small portions of the proceedings, where the tribunal felt that Canada in one instance, and the company in the other, had by its actions generated unnecessary costs.

In *Feldman v. Mexico*, under the ICSID Additional Facility rules, the Claimant prevailed on his national treatment claim but lost on the expropriation claim. The tribunal apportioned the ICSID costs equally, and required the parties to pay their own attorneys' fees. When Mexico requested review of certain portions of the award, which the tribunal rejected, the tribunal required Mexico to pay most of the ICSID costs of this portion of the proceeding, but not attorneys' fees.

Another possibly significant cost of arbitral proceedings is translation of pleadings and other documents, and simultaneous interpretation during the hearing or hearings. It is unusual in international arbitrations for all the parties, their counsel, the tribunal members and witnesses all to be fluent in a single language, e.g. English. Thus, it is likely that translation and interpretation will be necessary, at least to some extent. This problem may be mitigated if bilingual arbitrators can be selected, e.g., persons fluent in both English and Spanish in the U.S. cases against Mexico under NAFTA.

J. Miscellaneous Issues in Conducting the Proceedings

Regardless of the applicable rules, many of the procedural issues, such as the number and timing of the pleadings; the number and timing of the hearings; the operating language, the level of document discovery, exchange and service of documents, number of depositions and witnesses etc., will be decided by the tribunal, usually with the agreement of, **or at least after consultation with,** the parties. Some of this may be dictated by the procedural rules. For example, under the ICSID Rules, the first session of the tribunal is to be held within sixty days after it is created, unless the parties agree otherwise in consultation with the President of the tribunal. (Rule 13; AF Rules, Art. 21, are similar.) UNCITRAL Rules, Art. 15, gives the tribunal even more discretion with regard to the conduct of the arbitration, but requires a hearing if either party requests one.

Confidentiality of the proceedings may also be a factor of interest both to investors and to governments. Typically, proceedings are confidential unless otherwise noted. Even the awards are not automatically public. Under the UNCITRAL Rules, the award can be made public only with the consent of both parties. (Art. 32(5)) The same is true at the AF, but the Secretariat is authorized to "include in the publications of the Centre excerpts of the legal rules applied by the Tribunal." (Art. 53(3)) The same is true in ICSID cases (Rule 48(4)). A higher level of transparency may be provided for in the underlying investment agreement. For example, NAFTA provides that where the United States or Canada is a party to an investment dispute, either the government or the investor may make the award public; with Mexico, the issue is determined by the applicable arbitral rules. (Annex 1137.4)) The NAFTA Parties subsequently agreed to make most of the pleadings and the awards public, and Canada and the United States have agreed to hold open hearings.

The *ad hoc* nature of UNCITRAL proceedings, where the parties can set up their own secretariat, probably facilitates confidentiality of the proceedings. However, in most nations today, the public has an interest in international arbitrations that involve important public policy issues or may expose the governments to substantial payments from public funds. It is believed that most decisions therefore become public.

K. Seat of Arbitration and Location of Proceedings; Review of Award

1. Choice of Situs of Arbitration

Choice of the "seat" or "situs" of the arbitration is important for two reasons, to reduce costs and in determining where any court review of the award may take place. This is least important with arbitrations under the ICSID Convention, since no court review of the Award is possible. It is presumed that the proceedings will be at the Centre in Washington, but they may be held if the parties agree at the Permanent Court of Arbitration at The Hague or "any other appropriate institution" or in any other place approved by the tribunal. (Arts. 62, 63) In most instances ICSID proceedings are held at the Centre. The secretariat and all necessary assistance are present there, and the overall travel costs for Washington may be no more expensive than any other location.

Arbitration under the AF Rules must be in a country that is Party to the New York Convention. (Art. 19) Otherwise, the tribunal determines the place of arbitration after consultation with the parties. (Art. 20(1)) An important distinction is made between the place or seat of arbitration, where the award is legally made and is thus controlling for purposes of the award, and the place of tribunal meetings or hearings. (Art. 20(2)) This permits the tribunal and the parties to choose a place of arbitration in which national court review is deemed acceptable, and still have the proceedings at the Centre in Washington. Under the UNCITRAL rules, the place of arbitration is as agreed by the parties; in the absence of agreement, "such place shall be determined by the arbitral tribunal, having regard to the circumstances of the arbitration." (Art 16(1)) As with the other rules, the tribunal is free to meet elsewhere.

For example, in *Metalclad v. Mexico*, and AF case, the seat of the arbitration was British Columbia, Canada, but all meetings of the tribunal were held at the Centre. In *Feldman v. Mexico*, another AF case, the seat of the arbitration was Ottawa, Ontario. Both parties explicitly waived any objection to holding all sessions of the tribunal in Washington, D.C., notwithstanding, but the tribunal held one of its deliberative meetings in Ottawa nevertheless. The actual award was issued by the ICSID Secretariat in Washington, "made as at Ottawa, Province of Ontario, Canada, in English and Spanish." Court review took place in Ottawa. In *S.D. Myers v. Canada*, and UNCITRAL case, the seat was also Ontario. The *ad hoc* secretary was constituted in Toronto, Ontario, and all meetings, the hearing, and the issuance of the award took place in Toronto, as did court review. In *OEPC v. Ecuador*, the situs of the UNCITRAL arbitration was London, but some of the meetings were held in Washington.

The seat of arbitration is, as noted above, important for AF and UNCITRAL proceedings because it determines where the Award **may be subject to court challenge**. The UNCITRAL rules provide for "interpretation" of the Award, presumably for situations where the award is unclear (Art. 35) and for "correction," presumably where there has been a miscalculation of an award of financial damages. (Art. 36) An additional award can also be requested "as to claims presented in the arbitral proceedings but omitted from the award." (Art. 37) The AF Rules similarly provide for interpretation (Art. 55), "correction of any clerical, arithmetical or similar errors" (Art. 56) and for supplementary decisions "to decide any questions which it had omitted to decide in the award." (Art. 57(1)) Such requests are not uncommon, but are not a substitute for appeal. For example, in *Feldman v. Mexico*, Mexico requested action under Articles 55, 56 and 57, but the tribunal after careful review, with the exception of one minor clarification rejected Mexico's claims.

Neither the AF Rules nor the UNCITRAL Rules provide for any review or appeal of awards, except as noted immediately above. In the UNCITRAL Rules, the Award "shall be final and binding on the parties. The parties undertake to carry out the award without delay." (Art. 32(2). The AF Rules state that the "award shall be final and binding on the parties." (Art. 52(4)) However, this is not really the case **and, as noted earlier, the UNCITRAL Rules specifically are made subject to provisions of law from which the Parties cannot derogate, such as national legislation in the place of arbitration, which provide for limited court review**. **The** awards are subject to review by national courts, as such review is not excluded in either system. (NAFTA indirectly contemplates court review; it prevents a party from seeking enforcement of an award under the AF or UNCITRAL Rules until "three months have elapsed . . . and no disputing party has commenced a proceeding to revise, set aside or annul the award . . .." (Art. 1136(3)(b)(i).))

2. Issues in National Court Review

National court review is not likely to provide a high level of consistency, even in a particular country, though many nations have adopted the UNCITRAL Model Law on International Commercial Arbitration. Article 34 of the Model Law sets forth a very limited scope of review, following very closely Art. V of the New York Convention, quoted in Part II. Investors are likely to seek as the situs of arbitration locales which have adopted the UNCITRAL Model Law, where experience indicates that the courts will undertake only the limited review provided in Article 34, and not a *de novo* review of either the facts or the law as determined by the tribunal. However, even under this standard actual practice varies, as indicated by the NAFTA experience.

To date, under NAFTA, three arbitral decisions have been reviewed by a court at the "situs" of arbitration, in all cases one of the Canadian provinces:

In *United Mexican States v. Metalclad*, before the British Columbia Supreme Court [a court of first instance], the court concluded that the Tribunal acted beyond the scope of the submission to arbitration by finding a transparency requirement in Chapter 11 as the basis for determining that Mexico had violated arts. 1105 (fair and equitable treatment) and 1110 (expropriation) of NAFTA. (The tribunal's finding of indirect expropriation was upheld on other grounds.) The decision does raise some confusion as to the proper scope of review under Article 34 of the UNCITRAL Model Act as applied in Canada; the principal holding a "misstatement of the applicable law." In so finding, the court implicitly determined that it had jurisdiction to review alleged errors of law.

In *S.D. Myers v. Mexico*, a federal court sitting in Ottawa upheld the arbitral tribunal. The court declined to review a jurisdictional challenge based on Canada's allegation that there was no "investment" by S.D. Myers in a very formalistic approach. Since Canada raised a jurisdictional issue without labeling it as such in its Statement of Defense, according to the court Canada effectively waived its right to submit the issue as a "jurisdictional" challenge. More broadly, the court applied what it said were a "correctness" standard of review for legal issues (such as the meaning of the word "investor") and a "reasonableness" standard for application of facts to legal issues:

> Article 34 of the *Code* [UNCITRAL Model Code as adopted in Canada] does not allow for judicial review if the decision is based on an error of law or an erroneous finding of fact if the decision is within the jurisdiction of the Tribunal."

If the court in *Metalclad* had applied this standard it presumably would have affirmed the tribunal. Also, in *S.D. Myers*, presumed concerns over court review led to determinations "in the alternative."

Subsequent to the issuance of the court's opinion, S.D. Myers and Canada settled the case.

In *United Mexican States v. Feldman,* an Ontario provincial court, in dismissing the challenge afforded the tribunal a high degree of deference: "In my view, a high level of deference should be accorded to the Tribunal, especially in cases where the Appellant Mexico is in reality challenging a finding of fact. The panel that has heard the evidence is best able to determine issues or credibility, reliability and onus of proof." The Court also indicated that the public policy exception to enforcement should be invoked only when the award "must fundamentally offend the most basic and explicit principles of justice and fairness in Ontario, or evidence intolerable ignorance or corruption on the part of the arbitral Tribunal." The Mexican government has appealed this decision.

Given this divergent approach in Canada, there appears to be a current tendency in NAFTA, Chapter 11 arbitrations to select Washington, D.C. as the situs, which means that for AF and UNCITTRAL cases the federal courts in Washington would be the review courts in the event of a challenge. However, even here the issue is not fully predictable, because of the presence of a variety of different arbitration acts, including **the Federal Arbitration Act.**

3. **Review of ICSID Awards**

Under ICSID, as noted earlier, the arbitral system is self-contained. There is no possibility of court review. As in the AF and UNCITRAL rules, the tribunal may be requested to interpret the award as to its meaning or scope (Art. 50), or to revise it "on the ground of discovery of some fact or such a nature as decisively to affect the award, provided that when the award was rendered that fact was unknown to the Tribunal and the applicant . . ..” (Art. 51) Uniquely under ICSID, a party may also request that the award be annulled. Under Article 52, an award by a tribunal subject to annulment “on one or more of the following grounds:

> (a) that the Tribunal was not properly constituted;
> (b) that the *Tribunal has manifestly exceeded its powers*;
> (c) that there was corruption on the part of a member of the Tribunal;
> (d) that there has been a serious departure from a fundamental rule of procedure; or
> (e) that the award has failed to state the reasons on which it is based.

An *ad hoc* committee of three is appointed from a panel of Arbitrators, with the authority to annul the award or any part of it; if the award is annulled either party to the arbitration may request that the dispute be submitted to a new tribunal.

The ICSID Annulment Committee has overturned a number of ICSID decisions in favor of investors (*Wena Hotels v. Egypt* contra). More recently, in *Vivendi Annulment,* The Committee accepted the investor's claim and annulled the Tribunal's refusal to exercise jurisdiction even where its jurisdiction existed, determining that by so refusing the Tribunal had manifestly exceeded its powers under ICSID Convention, art. 52(1)(b). The process has also been criticized in the past for causing delays, although there is no reason to believe that the Annulment Committee process takes longer than national court review.

However, the consistency of the Annulment Committee process is also questionable. Since the members of the Committee (who may not have been involved in the underlying proceeding) are appointed on an *ad hoc* basis, the same individuals do not sit on the individual committees. (This is in contrast to the WTO's Appellate Body, where panels are appointed from a standing group of seven members, and all seven members participate in each AB decision.)

4. **Enforcement of Arbitral Awards**

The New York Convention applies to enforcement of arbitral awards against governments as well as private parties. The ICSID Convention requires all parties to enforce awards within their territories; such awards are to be treated as if they were final judgments in the constituent state. (Art. 54(1)) However, state immunity from execution of awards against certain assets is preserved in Art. 55. Under the Korea BIT, each party is required to “make provision for the effective enforcement of awards made pursuant to this article [Awards and Enforcement] and shall carry out without delay any such award issued in a proceeding to which it is a party.” (Art. 15(5). The VBTA contains similar language. (Art. IV(4)(6)) Under the Japan BIT, execution is subject to the requirements of national laws and regulations. (Art. 14(5)) This presumably means that in New York Convention countries the implementing laws would apply, and only very narrow exceptions to enforcement (and those relating to public fund under sovereign immunity principles) would apply.

There are relatively few instances in which a state has refused to pay an award issued under ISCID or the Additional Facility. However, some observers wonder whether, if many of the Claimants against Argentina prevail, with awards in the many billions, that government will be able to pay. **There are also a few instances in which an award was enforced under the New York Convention even though it had been nullified by the ICSID Annulment Committee (presumably because the enforcing court found fault with the annulment procedure).**

V. Substantive Issues

This is necessarily a brief treatment of a very complex series of issues, made more difficult by wide divergency of arbitral decisions interpreting various BIT provisions during the past 10-15 years. The examples are largely drawn from NAFTA Chapter 11 experience, but the similarity of the NAFTA language with the language of most other investment agreements makes them applicable more generally in most instances. Since the most important substantive protections for investors are national treatment, fair and equitable treatment and protection against expropriation, the discussion concentrates on these issues.

A. The BIT/VBTA Language

This part expands on the substantive coverage of the VBTA and BITs, beyond the brief summaries in Part II.

1. National Treatment and Most Favored Nation Treatment

The VBTA provides in Art. IV(2):

> With respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of covered investments, each Party shall accord treatment no less favorable than that it accords, in like situations, to investments in its territory of its own nationals or companies (hereinafter "national treatment") or to investments in its territory of nationals or companies of a third country (hereinafter "most favored nation treatment"), whichever is most favorable (hereinafter "national and most favored nation treatment").

The Japanese BIT provides in Article 2:

1. Each Contracting Party shall in its Area accord to investors of the other Contracting Party and to their investments treatment no less favorable than the treatment it accords in like circumstances to its own investors and their investments with respect to the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment, and sale or other disposal of investments (hereinafter referred to as "investment activities").

2. Each Contracting Party shall in its Area accord to investors of the other Contracting Party and to their investments treatment no less favorable than the treatment it accords in like circumstances to investors of any third country and to their investments with respect to investment activities.

Similarly, the Korean BIT provides, in Article 3:

(1) Each Contracting Party shall in its territory accord to investments and returns of investors of the other Contracting Party treatment no less favourable than that which it accords to investments and returns of its own investors or to investments and returns of investors of any third State, whichever is more favourable to investors.

(2) Each Contracting Party shall in its territory accord to investors of the other Contracting Party, as regards management, maintenance, use, enjoyment or disposal of their investments, treatment no less favourable than that which it accords to its own investors or to the investors of any third State, whichever is more favourable to investors.

These are basically straightforward provisions. Several comments are in order, however. First of all, in all investment agreements, the parties take reservations to these obligations. For example, in NAFTA, Mexico reserves for the state ownership and operation of petroleum producing and electricity producing activities. Secondly, the disputes over national treatment are likely to turn over whether the foreign investor and nationals are operating "in like circumstances" and whether, despite legal equality, in actual practice nationals of the host country are favored. Thirdly, it remains unclear whether the treatment of the foreign investor must be equal to the treatment of the most-favorably treated of the national investors operating under like circumstances.

The most favored nation provisions are particularly important for Vietnam because it is currently concluding a series of BITs. If a subsequent BIT provides the foreign investor with greater rights than provided to that investor in an existing BIT, that the investor may claim the more favorable treatment. Thus, to the extent that Japanese or Korean investors enjoy greater benefits under their BITs, once ratified, a U.S. investor could claim the same favorable treatment based on the VBTA provision quoted above.

2. Fair and equitable treatment and full protection and security

In NAFTA jurisprudence, this has become perhaps the most controversial provision, because of the difficulty of determining the scope of the international law requirement.

The VBTA (Art. IV(3)) provides:

1. Each Party shall at all times accord to covered investments fair and equitable treatment and full protection and security, and shall in no case accord treatment less favorable than that required by applicable rules of customary international law.

The Japan BIT (Art. 9) provides:

> Each Contracting Party shall accord to investments in of investors of the other Contracting Party fair and equitable treatment and full and constant protection and security.

The Korea BIT does not contain equivalent language, but Korean investors would arguably enjoy the protections of fair and equitable treatment through the MFN clause. It is also notable that the Japanese BIT provision does not contain the VBTA reference to "customary international law." Since this reference is viewed by the United States and Canada, and perhaps by other states as a limiting factor—providing only that level of treatment required by international law, which is not violated by every violation of the fair and equitable treatment standard—arguably the Japanese language gives a tribunal greater scope in finding a violation of the provision. As the case law indicates, as discussed below, deciding what *is* the minimum standard of treatment required under international law—with the states arguing that this is a very high threshold not breached by many annoying or unreasonable actions taken by states—is an ongoing process that is upsetting to many states, including the United States and Canada.

It is notable that the NAFTA language (Art. 1103(1)) is somewhat different from the VBTA and most U.S. BITS:

> Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

In this formulation, the obligation is treatment in accordance with international law, which includes fair and equitable treatment. Thus, the fair and equitable treatment obligation is *limited* to the requirements of international law. The different phraseology in the VBTA permits a construction in which the international law reference sets the minimum level of treatment contemplated by "fair and equitable treatment" but does not limit that concept to the (relatively high) requirements of international law. Thus, it would be possible for a tribunal to hold Vietnam to a *higher* standard of fair and equitable treatment than is required by international law.

3. **Expropriation**

This is perhaps the most common area traditionally of disputes between investors or host states. However, the situation of direct expropriation, where the host government's through use of its police power physically takes over the factory or mine, has become uncommon. More frequently today, some regulatory action of a host state significantly reduces the value of the investment (a partial taking), or a series of adverse actions in the aggregate make operations no longer profitable for the investor ("creeping" expropriation). These concepts of "tantamount to arbitration" or partial takings are most controversial, not in the developing world, but among non-government organizations in North America and Europe, who fear that otherwise valid health or environmental regulations will be construed as requiring compensation, and thus discourage such regulation in the future. Arbitral tribunals continue to struggle with these issues, despite the fact that the BIT provisions reflect developed country views of customary international law that date from the 1950s or before. Despite the variation in the language, it is unlikely that in most instances an arbitral tribunal would reach a different view based on the slightly differing language.

The "classical" expropriation standard is most closely followed in the Japan BIT, Art. 9, which provides:

> Neither Contracting Party shall expropriate or investments in its Area of investors of the other Contracting Party or take any measure tantamount to expropriation or nationalization (hereinafter referred to as "expropriation") except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) upon payment of prompt, adequate and effective compensation; and (d) in accordance with due process of law.

The calculation of compensation is similar to that provided in the VBTA.

The VBTA, Article 10(1), provides:

> Neither Party shall expropriate or nationalize investments either directly or indirectly through measures tantamount to expropriation or nationalization ("expropriation") except for a public purpose; in a non-discriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law and the general principles of treatment provided for in Article 3. Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken; be paid without delay; include interest at a commercially reasonable rate from the date of expropriation; be fully realizable; and be freely transferable at the prevailing market rate of exchange on the date of expropriation. The fair market value shall not reflect any change in value occurring because the expropriatory action had become known before the date of expropriation.

Finally, the Korean BIT provides, in Art. 5:

> Investments of investors of either Contracting Party shall not be nationalised, expropriated or subjected to measures having an effect equivalent to nationalisation or expropriation (hereinafter referred to as "expropriation") in the territory of the other Contracting Party except for a public purpose, under due process of law, on a non-discriminatory basis and provided that it is accompanied by prompt, adequate and effective compensation. Such compensation shall amount to the market value of the investment expropriated immediately before the expropriatory action was taken or became public knowledge, whichever is earlier, shall include interest from the date of expropriation at the applicable commercial rate and shall be made without delay, be effectively realizable and be freely transferable.

The Korean BIT also specifically provides for local court review of his expropriation claims and the valuation of the property (Art. 5 (2)). Presumably, however, the claimant must still choose between local court action and arbitration, as provided in Article 9.

5. Other Obligations to the Investor

Beyond these four major areas, the coverage of the investment agreements varies, but only to a relatively limited degree. The VBTA investment provisions include transparency obligations, limits on obligatory technology transfer and a general lack of restrictions on the "Entry, sojourn and Employment of Aliens" by the investor (Arts. 5, 7, 8) and incorporates the restrictions on performance requirements included in the WTO Agreement on Trade-Related Investment Measures. (Art. 11) The Korean BIT has repatriation of funds obligations (Art. 6) but no detailed performance requirements. The Japan BIT, in contrast, contains detailed performance requirements (Art. 4), transparency requirements (Art. 7) and currency convertibility obligations (Art. 12). (VBTA convertibility requirements are in Chapter VII.)

There has been relatively limited litigation on these issues in arbitral tribunals, although performance requirements have been the subject of a number of GATT/WTO actions (e.g., *Canada – Investment Review Act, Indonesia – Automobiles*).

B. **Examples from the Case Law**

The NAFTA investment protection provisions have produced a significant volume of litigation in ten years, primarily relating to national treatment (Article 1102), fair and equitable treatment (Article 1105) and expropriation (Article 1110). These provisions, in particular, have proved difficult for tribunals to apply in practice, and the governing law– the NAFTA agreement and "applicable rules of international law– has not always been clear. Because the NAFTA provisions are similar to those found in the VBTA, the Japan BIT and the Korean BIT, among many others, they are worth discussing. Also, the *Loewen* and *Mondev* cases are significant because the involve tribunal review of a dispute that was first submitted to a national court (as is often possible under NAFTA because of very limited "fork-in-the-road" provisions). There the standard of arbitral review is very high; it is not enough that the arbitral tribunal believes the court decision to be wrong. There must be a denial of justice (usually, a serious violation of due process) for the domestic court decision to constitute a violation of international law.

More than a dozen Chapter 11 actions brought by foreign investors against NAFTA host governments have resulted as of mid-2004 in decisions on the merits or other dispositive or partially dispositive opinions, and another twenty or so are in various stages of proceedings. A handful– *Metalclad v. United Mexican States, Loewen Group. v. United States, Pope & Talbot v. Canada, S.D. Myers v. Canada, Methanex v. United States*– have generated considerable attention among the NAFTA member governments (which appreciate losing cases no more than a developing country government or any private defendant), the foreign investment bar, and non-governmental organizations that are concerned with environmental protection, alleged erosion of national sovereignty or other problems, real or imagined. They are worth reviewing by any government contemplating a series of BITs and /or ICSID membership. Several non-NAFTA cases are also mentioned in this section.

Only four cases– *Metalclad, S.D. Myers, Pope & Talbot* and *Feldman Karpa v. United Mexican States*– have resulted in monetary damages awards against Canada or Mexico, but there have been no monetary damages awarded to date against the United States. Another group of cases– *Azinian v. United Mexican States, UPS v. Canada, Mondev v. United States, ADF v. United States, Loewen Group v. United States and Waste Management v. Mexico*– has resulted in a dismissal of all allegations against the respondent governments. Several of the most important cases are discussed below; this summary is not intended to be comprehensive, but it does provide some insight into key issues, as well as confirming that to date, at least, most Claimants under NAFTA Chapter 11 have lost! Most intermingle issues under Articles 1102, 1105 and 1110.

To date, Metalclad is the only NAFTA case in which an expropriation has been found, although the claimants in many others alleged expropriatory actions. *Metalclad* concerned the alleged expropriation of a hazardous waste disposal facility. The firm obtained all the necessary federal permits for its facility, relying on the federal government's assurances (which the tribunal concluded were accurate) that no state or municipal permits were required. However, the municipality denied the local permits required by Metalclad to legally operate the facility. According to the tribunal, the municipality by so doing exceeded its authority, and "effectively and unlawfully prevented the Claimant's operation of the landfill." This, said the tribunal, was an indirect expropriation. The Tribunal also found that the Mexican government had violated Article 1105 by its failure to provide a "transparent and predictable framework" for the investor in the latter's efforts to comply with Mexican laws regarding the siting of a hazardous waste disposal facility. In the tribunal's words, Mexico had failed "to ensure a transparent and predictable framework for Metalclad's business planning and investment." While the fair and equitable treatment and indirect expropriation violations based on denial of transparency were ultimately reversed by the British Columbia Supreme Court, the expropriation award was sustained on other grounds, i.e., the decision of the state government to treat the site as an ecological reserve, permanently excluding Metalclad from the site.

In *S.D. Myers*, the tribunal found a violation of Article 1102 (national treatment) on the basis of blatant and publicly documented discrimination between a hazardous waste processing facility in Alberta, Canada, and *S.D. Myers'* similar facility in Ohio. The *S.D. Myers* tribunal determined that the requirement of "fair and equitable treatment" had also been breached: "[O]n the facts of this particular case Canada's breach of article 1102 essentially establishes a breach of Article 1105 as well." The ground for this conclusion was that the "minimum standard" was considered broader in scope than the national treatment obligation. The *S.D. Myers* tribunal declined to find an expropriation, largely because the deprivation of S.D. Myers' property rights was temporary (for 18 months). However, the tribunal awarded damages based on the Article 1102 and 1105 violations in the amount of $6,050,000 plus interest. Canada sought to have the award reviewed and set aside in the federal court in Ontario, but the court effectively affirmed the Tribunal's decision, and Canada paid the award.

The "like circumstances" determination in S.D. Myers was easy; there was a foreign investor engaged in hazardous waste remediation (S.D. Myers), and one Canadian firm engaged in the same business. However, in some cases it can be more difficult to determine whether the investor is in "like circumstances" with national investors. For example, if only foreign investors are engaged in oil exploration and development, is there no basis for a national treatment claim because there are no nationals engaged in such exports, or is the investor "in like circumstances" with any other national investors who export goods and enjoy the usual VAT rebate? (The tribunal in *OEPC v.* Ecuador came to the latter conclusion.)

Pope & Talbot concerned allegations that Canada's implementation of its obligations under the 1996 Softwood Lumber Agreement with the United States violated NAFTA's requirements of national treatment and fair and equitable treatment, among others, and also constituted a compensable expropriation. The tribunal rejected claims of violation of national treatment because it found that Canada had treated the Claimant and Canadian lumber exporters in like circumstances equally. It also rejected the claim of an expropriation, based on claims that Canada's restrictive actions constituted a partial taking of the firm's investment. While the tribunal opined that partial takings in some circumstances might be compensable, in the present case the firm remained profitable at all relevant times.

However, the *Pope &* Talbot tribunal ultimately found a violation of fair and equitable treatment, initially on grounds that the concept was not limited by international law but was in addition to any international law obligations of Canada! (A government agency, in the tribunal's view had treated the Claimant unreasonably in seeking certain documents in an investigation, in a manner not much worse that investigating authorities commonly treat respondents in anti-dumping cases.) After more than three years and five major opinions, the tribunal awarded Pope & Talbot approximately $462,000 for the fair and equitable treatment violation, roughly 0.1 percent of the initial $509,000,000 original claim!

A similar approach (to that taken initially in *Pope & Talbot*) was taken in *OEPC v. Ecuador*, which was based on a BIT with language on fair and equitable treatment that is very similar to that found in the VBTA, quoted above. That language, at least in theory, permits a tribunal to decide that the host state's obligation of "fair and equitable treatment" is more extensive than the minimum standard required by international law. In *OEPC*, the tribunal decided that a change in the local tax laws to deny the Claimant VAT rebates that Claimant had been receiving in the past was a violation of the "fair and equitable treatment" standard, assuming but without really analyzing whether this was also a violation of international law. The tribunal in *OEPC* rejected the Claimant's arguments that the denial of the VAT rebate was an expropriation under the BIT, because there was no substantial deprivation of "the use or reasonably expected economic benefit of the investment [in petroleum production facilities]" as a result of the government's actions.

The concerns of the NAFTA Parties over *Pope & Talbot, S.D. Myers* and other assumed deviations from the customary international law standard prompted the first and to date only binding "Interpretation" of NAFTA Chapter 11, which*, inter alia*, stated that "The concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens." This was the NAFTA Parties' first effort to restrict the scope of the fair and equitable treatment concept, to situations where the government had acted in a truly outrageous manner. The Interpretation was extensively criticized by the *Pope & Talbot* Tribunal in a later opinion, and the tribunal suggested that the Interpretation might really be an amendment (which would be subject to constitutional processes in the three countries). However, in the end the Tribunal grudgingly accepted that the action, but nevertheless held that the Canadian action was a "fair and equitable treatment" violation even under this narrower standards. Language in the United States - Chile FTA attempts to resolve at least some of this confusion by including the term "customary international law" in the fair and equitable treatment provision, and defining that term in much greater detail.

In *Methanex*, as noted earlier, the Canadian firm challenged the action of the State of California in banning the gasoline additive, MTBE, because of the perceived risks of MTBE pollution of the underground water supply. Methanex manufactures methanol, which is the principal ingredient in MTBE, and argued that the measures taken by California constituted a "substantial interference and taking of Methanex US' business and Methanex's investment in Methanex US. These measures were characterized both directly and indirectly tantamount to expropriation." However, the original tribunal did not reach the question of whether California's action constituted a compensable taking under Article 1110. Rather, the original complaint was dismissed on grounds that the connection between the California MTBE ban and Methanex' operations was not "legally significant" so as to satisfy the "relating to" language in NAFTA, Article 1101. The action remains pending.

Of course, whether the regulatory actions are "valid" under Article 1110 is to be determined by the adjudicatory process. It is notable that the recently concluded United States - Chile Free Trade Agreement, the investment provisions of which are generally similar to those found in NAFTA, Chapter 11, contains an annex designed to restrict, perhaps significantly, the scope of the "indirect" expropriation provisions as they may apply to government regulatory activities:

> Except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriation.

Similar limiting language is found in the new U.S. Model BIT and subsequent FTAs.

In Loewen, a Mississippi state court trial alleged to have been conducted in an intentionally prejudicial manner had resulted in a verdict against Loewen (a Canadian operator of funeral homes) of approximately \$100 million in actual damages and \$400 million in punitive damages, in a commercial transaction worth less than \$5 million. Because the claimant allegedly could not meet bonding requirements for an appeal, set at \$625 million, Loewen settled the case for \$175 million, "under conditions of extreme duress" and brought a Chapter 11 claim. Among Loewen's contentions was that actions of the trial court, the excessive judgment and the bonding requirements were violations of NAFTA, Article 1105, in that Loewen was denied justice and denied fair and equitable treatment by the Mississippi courts.

In partial response, the United States argued, *inter alia*, that the treatment accorded to Loewen by the courts of Mississippi could not be shown by claimant to be "below the international minimum standard required by Article 1105." The United States had contended that the fact that "the Tribunal must consider the entirety of the United States' system of justice stems from the nature of the customary international law obligation that gives rise to State responsibility for denial of justice." The United States ultimately prevailed. The tribunal agreed that the Mississippi court decision was "a disgrace"; it was "clearly improper and discreditable and cannot be squared with minimum standards of international law and fair and equitable treatment." However, the tribunal agreed with the United States that Loewen had failed to adequately pursue available domestic remedies, preventing Loewen from prevailing on its denial of justice/denial of fair and equitable treatment under international law claims.

Loewen was ultimately dismissed on procedural grounds, as noted earlier, with the Tribunal holding that availability of the Chapter 11 mechanism was lost when Loewen, in bankruptcy, transferred its interests to a U.S. firm. While the Tribunal termed the process in the Mississippi state court a "disgrace," it concluded that the decision was not cognizable under NAFTA and international law because Loewen had not exhausted its legal remedies within the United States court system. This has not prevented anti-NAFTA groups in the United States from seizing on Loewen as "an all-out attack on democracy. If successful, it would undermine the jury system, which is fundamental to our system of justice." This is an important case in situations where a Claimant challenges a local court decision as a denial of justice, because it suggests that international law is not breached unless there are serious denials of procedural due process going beyond the facts of *Loewen*.

In *Mondev v. United States*, the Claimant directly challenged the Interpretation, the meaning of fair and equitable treatment and the requirements of customary international law. However, since Mondev had chosen to invoke the protection of local courts, which had decided against the firm, the tribunal limited its review to "that aspect of the Article 1105(1) which concerns what is commonly called denial of justice, that is to say, with the standard of treatment of aliens applicable to decisions of the host State's courts or tribunals." Like Pope & Talbot, Mondev also argued that the Interpretation was effectively an amendment to NAFTA, permitted only "with the applicable legal procedures of each Party." If the appropriate standard was found to be customary international law, Mondev argued that "that law had to be given its current content, as it has been shaped by the conclusion of hundreds of bilateral investment treaties, including NAFTA, and by modern international judgments and arbitral awards."

The United States, in defending the Interpretation and criticizing the *Pope & Talbot* Tribunal, contended that "customary international law" meant just that, and the BITs were not relevant unless it could be shown that they reflected *opinio juris*. The United States also sought to discredit arbitral decisions that attempted to apply standards of customary international law based on a specific treaty. Both Mexico and Canada admitted that the customary international law standard could evolve over time. However, both countries still argued that the threshold for finding a violation of customary international law in this area was high, or required evidence of an "arbitrary action substituted for the rule of law" for a violation. In *Mondev,* the tribunal examined whether the content of customary international law providing for fair and equitable treatment and full protection and security in investment treaties was any different than it was in the 1920s. The tribunal held that the "substantive and procedural rights of the individual in international law have undergone considerable development," "to the modern eye, what is unfair or inequitable need not equate with the outrageous or egregious," and that "a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith."

The tribunal also recognized that dozens of nations' BITs had influenced the content of the rules governing the treatment of foreign investment in current international law by obligating parties to accord foreign investment fair and equitable treatment. While the United States conceded the significance of the jurisprudence of state practice and arbitral tribunals, it also contended that a tribunal still could not "adopt its own idiosyncratic standard of what is 'fair or equitable' without reference to established sources of law." The tribunal reasoned that the reference to "customary international law" in the Interpretation must mean that status of that body of law no earlier than 1994, when the NAFTA came into force. As a result, where the tribunal found no denial of justice, there could be no violation of Article 1105, and the tribunal dismissed Mondev's claim. The fact that *Mondev* was written by former ICJ Chief Justice Stephen Schwebel probably gives it more impact that the average NAFTA arbitration decision.

A somewhat similar analysis of Article 1105 and customary international law occurred in *ADF Group v. United States*, where the tribunal focused on the key question of whether the enforcement of a federal "Buy American" provision precluded ADF from fabricating steel for guardrails to be sold in Virginia, and was therefore a violation of Article 1105. Thus, customary international law is the standard applicable in Article 1105. However, the tribunal recognized that Article 1105 is something more than a rule against discrimination between domestic and foreign investors. Presently, the United States, Mexico, and Canada all agree that the Interpretation refers to customary international law as it exists today, although Mexico and Canada continue to remind tribunals that "the threshold remains high" for a violation of that standard. However, this does not mean that the investor had demonstrated that there exists, "a general and autonomous requirement (autonomous, that is, from specific rules addressing particular, limited, contexts) to accord fair and equitable treatment and full protection and security to foreign investments" in today's customary international law. In *ADF Group*, the investor simply did not make his case that such U.S. domestic measures as domestic content and performance requirements in the peculiar context of government procurement are violations of fair and equitable treatment as that term is used in NAFTA.

D. Some Comments on the Substantive Issues

As this discussion indicates, it is often very difficult to predict the results of arbitration under ICSID, the AF or UNCITRAL Rules. Each tribunal is comprised of arbitrators selected on an *ad hoc* basis, and in many cases the host government is able to select only one arbitrator (if the ICSID Secretary-General or other Appointing Authority designates the President of the Tribunal, as is often the case). Moreover, historically jurisdictional challenges that result in dismissal of the action are very difficult to win. While in many instances certain claims may be dismissed (e.g., the expropriation claims in *S.D. Myers, Pope & Talbot, Feldman* and *OEPC*) other claims are likely to survive, in part because a national treatment violation may also be considered to be a fair and equitable treatment violation and indication of an expropriation violation as well. (Some cynics would argue that dismissal on jurisdictional grounds is unusual in part because it would mean that the arbitrators would have to go home and wouldn't be paid any further for their services!)

In the three major substantive areas, expropriation, national treatment and fair and equitable treatment, interpretation of the expropriation is probably the narrowest and most predictable (although as noted earlier some NGOs and governments are concerned by potential determinations of expropriations as a result of otherwise legitimate government regulatory actions). Most of the national treatment cases involve fairly obvious discrimination between foreign investors and national investors; the most difficult issues relate to determining which are "in like circumstances."

It is the area of "fair and equitable treatment" which is most unpredictable. Is such a finding limited by the available international law standard, in which not every governmental action that unfavorably affects the foreign investor rises to the level of an international wrong? Or, particularly under the VBTA and similar BIT language, is any significantly unreasonable or unfair or arbitrary action by the host government compensable?

Tucson: August 17, 2004

Annex - Some Useful Sources

Rudolf Dolzer & Margrete Stevens, BILATERAL INVESTMENT TREATIES (1995)

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UNCTAD, Dispute Settlement – International Centre for the Settlement of Investment Disputes (UNCTAD, 2003) (http://www.unctad.org/)

UNCTAD Compendium of Investment Agreements (http://www.unctadxi.org/templates/DocSearch.aspx?id=780)

ICSID Convention and Arbitral Rules (http://www.worldbank.org/icsid/)

ISCID Additional Facility Rules (http://www.worldbank.org/icsid/)

UNCITRAL Arbitral Rules http://www.uncitral.org/en-index.htm

NAFTA Chapter 11 Decisions and Pleadings (http://www.naftalaw.org)

Permanent Court of Arbitration (http://www.pca-cpa.org/)