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INTRODUCTORY REMARKS:[1] AN OVERVIEW OF INVESTMENT ARBITRATION

JOSHUA FELLENBAUM†

Thank you very much Professor Sundahl, and good afternoon ladies and gentlemen. It is a pleasure to be back in Cleveland, Ohio, and it is great to be at Cleveland-Marshall College of Law. Before I begin, I would like to thank and congratulate the law students who put together this global symposium.

The topic I was asked to speak about today is investment arbitration. For those practitioners and scholars on the panel and in the audience who have experience in investment arbitration, you know that it contains a number of complex issues and nuances, so it is quite a tall task ahead of me. What I hope to do in the next twenty to twenty-five minutes is to provide you with a broad overview of investment arbitration. We will examine the structure of investment arbitration along with the substantive and procedural issues that tend to arise in investment disputes.

Before we jump into the details of investment arbitration, I think it is helpful and appropriate to first take a step back and look at a practical example. The case of *Bernardus Henricus Funnekotter and Others v. Republic of Zimbabwe* is an actual investment dispute that involved Dutch nationals who directly or indirectly owned large commercial firms in Zimbabwe. The Dutch nationals alleged that they were deprived of their investments by Zimbabwe through actions that were tantamount to expropriation. The question that must be asked at the outset is where could these Dutch nationals seek recourse against the government of Zimbabwe for this alleged expropriation?

One obvious option would be for these Dutch nationals to rely on the municipal courts of Zimbabwe, but it is quite difficult for a foreign investor to go into the municipal courts of any host state, sue the host state, and prevail. Another option would be for these Dutch investors to rely on an investment instrument entered into by the government of the Netherlands and the government of Zimbabwe in which, *inter alia*, the government of Zimbabwe afforded certain protections to investments made by Dutch investors in its territory. The Dutch nationals chose to rely on the provisions found in this Netherlands-Zimbabwe Bilateral Investment Treaty ("BIT"), and a tribunal ordered them to be compensated by Zimbabwe. Throughout our examination today, we will look at the particular provisions of this Netherlands-Zimbabwe BIT.

What is an investment dispute? It is a dispute between a foreign investor and a host state which relates to an investment made in the territory of the host state. As we saw in the practical example, the foreign investor was a Dutch national, the host state was Zimbabwe, and the investment was made in the territory of Zimbabwe.

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We need to understand what these investment instruments are because they serve as the general framework of investment arbitration. Investment treaties can take different forms. They can be multilateral treaties. They can be bilateral treaties. They can be free trade agreements like NAFTA. They can be something called the Energy Charter Treaty, which is just focused on energy disputes. But today, we will focus on "BITs".

BITs are agreements between two nations by which they agree to certain rules that govern investments undertaken by nationals of one treaty party in the territory of another treaty party. They create binding legal obligations under public international law and they generally provide for a dispute settlement mechanism. The aim of these investment treaties is two-fold. One is investment protection – we'll look at the substantive protections later on – and the other is investment promotion. A large chunk of these international investment treaties are entered into by developing nations. Developing nations generally enter into these treaties to promote foreign direct investment and balance out any potential risks. So what developing nations, in essence, say is, maybe we don't have such a strong economy or maybe the legal system is not that stable, but if you invest in our country, we will protect your investment and assure its protection through these international investment agreements.

Most investment treaties allow investors to refer disputes with the host state directly to binding international arbitration under different regimes. Some refer disputes to the SCC. Others refer disputes to the ICC. Some refer disputes to ad hoc arbitration under the UNCITRAL rules. Most (or more than half) of these treaty cases have been referred to the International Centre for the Settlement of Investment Disputes Convention.

If we go back to our BIT that we talked about at the beginning between the Netherlands and Zimbabwe, we look at Article 9.1 which provides a six month "cooling off" period for the parties to try and reach an amicable settlement before the dispute can be referred to arbitration. In Article 9.2 it states that "[e]ach Contracting Party hereby consents to submit such legal dispute to the International Centre for the Settlement of Investment Disputes," and that's known as the ICSID Convention or the Washington Convention.

ICSID was set up as an institution in 1965 within the World Bank Group to provide facilities for the neutral resolution of foreign investment disputes between states and foreign investors. What is important about ICSID is that most states will comply with the award for two fundamental reasons: 1) they do not want to risk losing any potential investors or investments, and 2) they do not want to risk damaging their relationship with the World Bank.

157 states have signed the ICSID Convention and 146 have deposited their instruments of ratification. Contracting and signatory states range from Afghanistan to the Bahamas to Mongolia and, as we saw, to Zimbabwe.

Thirty-five years after ICSID was established it registered only 66 arbitration cases. In the years since, the number of cases has grown to over 200. In financial year 2010, ICSID had registered 27 new cases, administered 154 ongoing cases, and concluded 34 proceedings.

What is unique about the ICSID Convention is that it contains special jurisdictional requirements which are set out in Article 25, and one of the requirements is that there must be a legal dispute arising directly out of an investment. The founding fathers of the ICSID Convention left the term "investment" undefined.

If we look at our Netherlands-Zimbabwe BIT, which provides consent to the ICSID Convention, we see that the contracting states did define the term investment, and they defined it very broadly. They have an open-ended, asset-based definition, set forth in Article 1.1, that states "the term 'investments' shall comprise every kind of asset . . . ."

This has caused tension within the arbitration community and is widely debated at a number of arbitration conferences throughout the world. Although it is a difficult topic, I will try to explain the two approaches. One is known as the subjective approach. This approach follows that a tribunal will look at the economic activity – whether it is a salvaging project, whether it is owning commercial farms, or whether it is building a highway – and if the economic activity is deemed an investment within the applicable BIT or contract, then it's automatically an investment under Article 25 of the ICSID Convention. The other approach is known as the objective approach or the "double-barrel approach." Tribunals that follow this approach say that the dispute between the parties must be an investment within the definition provided under the relevant consenting instrument and also the objective criteria of an investment within the meaning of Article 25. Objective thinkers, therefore, import common characteristics of an investment into Article 25.

One case that illustrates this tension between the two approaches is *Malaysian Historical Salvors v. the Government of Malaysia*. This case concerned a contract with the claimant, who was a marine salvaging company, and the Malaysian government for the locating and salvaging of the cargo *Diana*, a British vessel that sank off the coast in 1817. This case was decided by a sole arbitrator. The distinguished arbitrator reached the conclusion that the claimant had expended its own funds in the performance of the contract in its entirety. The contract took almost four years to complete, satisfying the duration element in the quantitative sense. Additionally, the claimant assumed all of the risk under the contract satisfying this element in the quantitative sense. Despite this, the distinguished arbitrator ultimately decided that the economic activity—the salvaging contract—did not qualify as an investment because the contribution to the economic development of the host state was not significant. As such, the sole arbitrator determined that the salvaging project did not benefit the Malaysian public interest in a material way or serve to benefit the Malaysian economy.

Not all BITs have a broad, open-ended, asset-based definition. As we saw in the Netherlands–Zimbabwe BIT, it was very broad. But if we look at the U.S. model BIT, it says that an investment has to include the common characteristics of an investment.

We will now look at the substantive provisions commonly found in BITs, while focusing on the particular language in the Netherlands-Zimbabwe BIT. I will focus on different cases in which these certain protections played a fundamental part.

If we look at Article 3.1 of the Netherlands-Zimbabwe BIT, it says that "Each Contracting Party shall ensure fair and equitable treatment of the investments . . . ." This is one of the most common standards found in investment treaties. In one case, *MTD v. Chile*, the tribunal stated that, in its ordinary meaning, the term "fair and equitable" means just, even-handed, unbiased and legitimate. In *Tecmed v. Mexico*, the tribunal stated that the foreign investor expects the host state to act in a consistent manner free from ambiguity and totally transparently in its relations with the foreign investor so that it may know beforehand any and all rules and regulations that will govern its investment.

One more case I would like to share is *Occidental v. Ecuador*, which took place in 2004. The tribunal found that Ecuador had breached the above standard when its tax agency decided that Occidental Exploration and Production Company was not entitled to claim reimbursement for VAT oil exports, despite the fact that it had been so entitled when it originally made its investment. The tribunal found that Ecuador's failure to provide a stable and predictable regulatory framework violated this treaty standard.

Another common protection is the full protection and security guarantee, which concerns the protections afforded to the investors' property by the host state from damage caused to it by host state officials or others acting within the host state's jurisdiction. What is important to note about this provision is that it may be breached even if no physical violence occurs. In one case, *Wena Hotels Ltd. v. Arab Republic of Egypt*, the dispute concerned the seizure of a hotel by its employees. The tribunal found Egypt responsible for the failure to accord this investment full protection and security because it did not take any action to prevent the seizures or to immediately restore control over the hotel.

Another common protection is expropriation without just compensation. What is interesting about international investment arbitration is that there can be direct expropriation and indirect expropriation. Direct expropriation is a taking by the state of property that belongs to the investor without just compensation. One case that dealt with expropriation was *Swenbalt v. Latvia* from 2000. Swedish investors purchased a renovated ship to be used as a floating trade center and they docked it in Latvia. Without notice, the port authority subsequently moved the ship and sold it at an auction. The tribunal determined that the Republic of Latvia, by taking the ship away, preventing the investor from using it, and finally, by auctioning it and permitting it to be scrapped without any compensation to the investor, had breach the obligations under the BIT.

As mentioned, there is something called "indirect expropriation," and we see it in Article 6(c) of the Netherlands-Zimbabwe BIT. This is a measure that does not involve an overtaking of the tangible property, but it effectively neutralizes the enjoyment of the property. An example of this can be a disproportionate tax increase.

If we look at Article 3(2) of the Netherlands-Zimbabwe BIT, we will see that there is a provision for national treatment. Under this provision, investors must be treated equally with local competitors. Host states cannot offer more favorable conditions to their own nationals or companies or place more onerous conditions on foreign investors.

A case that illustrates this protection is the NAFTA case *Feldman v. Mexico*. The issue in this case was whether the Mexican government violated this provision by granting tax rebates to Mexican-owned exporters of cigarettes while refusing the same rebates for an American-owned exporter. The Mexican government argued that it rightfully denied the rebates because a U.S.-owned company could not produce itemized invoices showing the specific amount of tax paid for the cigarettes as required by Mexican law. The claimant, the U.S. company, showed that the Mexican companies, which purchased their cigarettes from the same retail sources and could not have itemized invoices, nonetheless received rebates during this relevant time.

Another protection is called the MFN provision, or "most favored nation" provision. A typical MFN clause provides that each contracting state shall treat investors of the other contracting state no less favorably than it treats investors of a

third country. As opposed to national treatment which looks at local investors, the MFN clause looks at treatment of investors in a third country.

One case, *MTD v. Republic of Chile*, involved a Malaysian investor; the applicable BIT was between Malaysia and Chile. The Malaysian investor who had been denied zoning changes necessary to undertake a land development project successfully argued that the MFN clause in the Malaysia-Chile BIT made the provisions of the Croatia-Chile BIT and the Denmark-Chile BIT applicable. Both of those BITs provided that, when a contracting party has admitted an investment in its territory, it shall grant the necessary permits in accordance with its laws and regulations.

Now we will talk about the enforcement of ICSID awards. As mentioned, what is interesting about ICSID is that contracting states must recognize the award as final and binding, appealable only under the Convention. As such, a losing party may, within 120 days of the decision, apply for the award to be rectified, interpreted, revised, or annulled. The Secretary General of ICSID will appoint an annulment committee to determine if the tribunal breached any of the provisions. This may happen if there is a serious allegation of corruption, if the tribunal departed from a fundamental rule of procedure or if the tribunal manifestly acted in excess of their powers. Without saying whether the sole arbitrator in *Malaysian Historical Salvors v. the Government of Malaysia* was correct or incorrect, the sole arbitrator's decision that the economic activity of the salvaging contract was not an investment was annulled, and an ad hoc committee set it aside because, *inter alia*, the distinguished arbitrator did not also analyze whether the economic activity was an investment under the applicable BIT. The distinguished arbitrator only analyzed whether it was an investment under Article 25 of the ICSID Convention.

I will just conclude by reflecting upon the current events going on today, for example in Libya. Due to the unrest in Libya, potential investors may look to investment treaties to recover from any harm or loss caused by recent events. We talked about full protection and security. We talked about expropriation. We talked about other provisions. Libya has entered into 30 BITs with 17 of them being in force. Some of those in force include treaties made with Switzerland, Spain, and France. As such, investors based in these countries may look to the applicable BIT provisions to protect their investments.

I thank you very much for your esteemed attention and patience.