CHAPTER XX

INVESTMENT DISPUTES

The relationship between a foreign-based corporation and a host nation is almost designed to encourage disputes. At the beginning of the relationship, the bargaining power usually lies almost entirely with the corporation. In a few cases the corporation has little choice but to invest, for example, when it is interested in a host-nation market that is protected by high tariffs or by domestic content provisions. But in general and particularly if the corporation is planning to extract or manufacture goods for export, it does not have to invest in a particular nation. It may even be in a position of choosing among different nations that compete against one another to offer the most favorable investment terms. Even without corruption or a subservient government, then, the initial terms of an investment contract are likely to favor the corporation.

Everything changes after the corporation has actually made its investment. It has now brought in assets—and the host government can at any time seize those assets to enforce a new decree or policy. Even with the best faith, disputes become likely—labor relations might not work out or a new government might want to change its tax policy in a way not envisioned at the time of the investment. And, looking back, the commitments made by the government to the firm at the time of investment may now look unduly favorable to the firm. This will almost certainly be the case (at least politically) in extractive industries. Once the oil has been found and the risk is past, the rate of return appears high; it is easy to forget that that rate of return must cover the cost of dry wells as well as of successful ones.

The result is almost always renegotiation. In this process, the host nation always has the practical alternative of expropriating the corporation, a possibility that greatly affects the relative bargaining positions of the two. It is no surprise that most long-term contracts, for example, the oil concessions in the Middle East, have been regularly modified in favor of the host nation. The initial contractual allocation of profits was very favorable to the finns; over time the contract was renegotiated so as to favor the host nation. This occurs even without revolutionary change in the host nation; if that nation changes in a revolutionary fashion–Mexico in 1917, Cuba in 1959, or Iran in 1979–reallocations are likely to be much more dramatic, and expropriation very common.

This chapter explores these interrelated questions of dispute settlement and expropriation. It does not seek to explore the closely related international law doctrines of act of state and sovereign immunity. This chapter seeks rather to examine the practical business issues and solutions that have evolved. It emphasizes the arbitration arrangements designed to restrain disputes short of expropriation, the insurance arrangements that a firm can use to protect itself from arbitration, and the emerging network of international treaties designed to assist the investment process and to avoid investment disputes.

A. DISPUTE SETTLEMENT PROCEDURES

The lawyer's obvious way to control disputes is to create dispute settlement procedures. But the problem arises at once of choosing among legal systems. Relying upon the host nation's legal system appears unfair to the investor, because that nation's government is so interested in the outcome. Even so, this system is the obvious basis of settlement and the one that would automatically be used in the developed world. But sometimes one cannot be confident of the courts. And the courts of almost any legal system would feel bound to follow new legislation—and host-nation law might be changed in a way that is extremely unfavorable to the firm. Although a firm might seek alternatively to contract for application of foreign law, this is often unacceptable to the nation. Moreover, some issues undoubtedly should be handled flexibly by local law.

In the face of these dilemmas, which go to both choice of law and choice of forum, the traditional solution, except in Latin America, has been to negotiate a procedure for settling disputes through arbitration. Note that this form of arbitration, typically between a private firm and a sovereign government, can raise great political difficulties, There is usually a somewhat ambiguous provision for choice of law, designed to leave the nation reasonable flexibility in changing the law, but also to protect the firm from seriously adverse legal changes. The arbitration agreement was once spelled out ad hoc in the initial investment agreement or concession; more recently, many firms and nations are adopting a new international procedure, the International fDentre for the Settlement of Investment Disputes (ICSID).

Latin American nations, however, have generally resisted this approach, arguing that a foreign investor should be treated no differently from a domestic investor. Since the domestic investor has no access to special dispute settle ment arrangements, neither should the foreign investor. Hence, all these arbitration agreements are rejected, and the investor is asked as well to accept a "Calvo clause," a provision under which it promises riot to call in diplomatic pressure in the event of a dispute. As will be seen below, the Calvo clause has often failed to achieve its goal.

1. Arbitration Procedure

Now a classic of modern arbitration, the *TOPCO* case excerpted below resulted from 1973 and 1974 nationalizations of Libyan oil concessions originally granted in 1955. The arbitration award was issued in 1977 by a French arbitrator over the opposition of the Libyan government, and was ultimately honored (with a compromise amount) by that government. *See* Von Mehren &. Kourides, International Arbitrations between States and Foreign Private Parties: The Libyan Nationalization Cases, 75 A.J.L.L. 476 (1981).

TEXAS OVERSEAS PETROLEUM CO. AND CALIFORNIA ASIATIC OIL CO. v. THE GOVERNMENT OF THE LIBYAN ARAB REPUBLIC

17 Int'l Leg. Mat. 3 (1978)

Dupuy, Sole Arbitrator.

Introduction

On September 1, 1973 and February 11, 1974, the Libyan Arab Republic promulgated decrees purporting to nationalize all of the rights, interests and property of Texaco Overseas Petroleum Company and California Asiatic Oil (Zmpany (the "Companies") in Libya granted to them jointly under 14 Deeds of Concession. The Companies objected to the decrees arid claimed that such action by the Libyan Government violated the terms and conditions of their Deeds of Concession.

Exercising their rights under their Deeds of Concession, the Companies requested arbitration and appointed an arbitrator. The Libyan Government refused to accept arbitration and did not appoint an arbitrator. Pursuant to the arbitration provision in their Deeds of Concession, the Companies requested the President of the International Court of Justice to appoint a sole arbitrator to hear and determine the disputes. The Libyan Government opposed such request and filed a memorandum with the President contending, *inter alia*, that the disputes were not subject to arbitration because the nationalizations were acts of sovereignty. This memorandum represented the only appearance by the libyan Government in the arbitration proceedings.

After considering the Libyan Government's objections, the President of the International Court of Justice, on December 18, 1974, appointed René-Jean Dupuy, Secretary General of The Hague Academy of International Law and Professor of Law at the University of Nice, as the Sole Arbitrator. Professor Dupuy named Jean-Pierre Sortais, Professor of Law at the University of Nice, as the Registrar of' the Arbitral Tribunal.

Resolving first the procedural aspects of the Arbitration, the Sole Arbitrator then determined that the initial stage of the Arbitration should be devoted to the question whether he had jurisdiction to hear and determine the disputes. He invited the parties to submit memorials in support of their positions and the Companies submitted their Memorial on the Jurisdiction of the Sole Arbitrator on June 16, 1975. It should be noted that although the Libyan Government did not submit a memorial during the jurisdictional or merits phase of the Arbitration, the Sole Arbitrator did specifically consider at each phase of the arbitral proceedings the arguments raised by the Libyan Government in its memorandum referred to above.

On Noveniber 27, 1975, the Sole Arbitrator delivered a Preliminary Award deciding that he had jurisdiction to hear and determine the disputes between the parties. The Preliminary Award was delivered in the French language and the following version ... is the Companies' authorized English translation.

The Sole Arbitrator immediately proceeded to the next phase of the Arbitration to determine the merits of the disputes. The damages portion of the Arbitration was reserved for a later phase if necessary, The Sole Arbitrator again invited the parties to subndt memorials in support of their positions and the Companies submitted their Memorial on the Merits on February 28, 1976. On June 15 and 16, 1976, the Arbitral Tribunal held oral hearings in Geneva at which time the Companies presented their case and responded to a series of questions asked by the Sole Arbitrator.

On January 19, 1977, the Sole Arbitrator delivered an Award on the Merits in favor of the Companies. The Sole Arbitrator held that (a) the Deeds of Concession are binding on the parties, (b) by adopting the measures of nationalization, the Libyan Government breached its obligations arising under the Deeds of Concession and (c) the Libyan Government is legally bound to perform the Deeds of Concession and to give them their frill force and effect. The Award on the Merits was delivered in the French language and the following version . . . is the Companies' authorized English translation.

Award on The Merits . . .

33. As Dr. F. A. Mann wrote (Studies in International Law (1973), at 223):

> . . . [I]n regard to treaties between international persons, the nature and subject matter of which frequently are not substantially different from contracts between international and private persons, those legal rules have been, or arc capable of being, and, in any event, must be developed. The law which is available icr application to the one type of contractual arrangement can, without difficulty, be applied to the other group of contracts.

Commenting on this point in a recent article ("*Contrats entre Etats et Personnes Privées Jitrangères: The Theoretical Approach towards the Law Got 'erning Contracts between States and Private Persons*", Rev. Belge D.L 562 (1975), at 564-565), Professor Mann writes further:

> Although normally the law of a given State will govern the State contract, precisely years ago another possible solution was suggested. it was said that a contract between a State and an alien private person could be "internationalized" in the sense of being subjected to the only other legal order known to us, namely public international law. This does not mean or was ever intended to mean that the State contract should be considered to be a treaty or should he. governed by public international law in the same way as transactions between States. It simply nieans that by exercising their right to choose the applicable legal system the parties may make public international law the object of their choice. Certainly French law is designed normally to apply to French people or French transactions, Certainly public international law is designed to apply as a rule to States and the transactions between them. But nothing prevents a contract between the German State and a i)utch firm to be submitted to French law, Similarly, the fact that one party is not a State should not prevent the contract from being submitted to public international law. It would thus become subject to the mandatory rules of public international law. No mandatory law of any national system as such could touch it, If the parties desire this, why should we put any obstacle in their way? . . . Of course, we trust guard against abuse. For this reason the teachings of private international law in general are to the effect that the choice of the legal system adopted by the parties must he reasonable, free from capriciousness, supported by rational, legitimate grounds. These conditions will be fulfilled if one party to the contract is a State or, one may add, a State corporation, though for reasons of social policy private persons contracting among themselves should be precluded from choosing a legal system other than a national one. The public international law thus applicable within a limited field would normally be found in the general principles accepted by civilized nations.

35.This Tribunal therefore holds that it is established that the Deeds of Concession in dispute are within the domain of international law and that this law empowered the parties to choose the law which was to govern their contractual relations.

2. Second Question

36. Under what circumstances was the choice of applicable law made and what consequences should be derived therefrom as to the internationalization of the Deeds of Concession in dispute?

(a) In its final version, the clause designating the applicable law or the choice of law established by Clause 28 of the Deeds of Concession reads as follows:

> This concession shall be governed by and interpreted in accordance with the principles of the law of Libya common to the principles of international law and, in the absence of such common principles, then by and in accordance with the general principles of law, including such of those principles as may have been applied by international tribunals. ...

40. As the Tribunal has already observed . . . the internationalization of contracts entered into between States and foreign private persons can result in various ways which it is now time to examine. . . .

42. International arbitration case law confirms that the reference to the general principles of law is always regarded to be a sufficient criterion for the internationalization of a contract. One should remember, in this respect, the awards delivered in *Lena Goldfields v. U.S.S.R.* in 1930, *Petroleum Development Ltd. v. Sovereign of Abu Dhabi* in 1951, and *International Marine Oil Company v. Sovereign of Qatar* in 1953, and in *Sapphire International Petroleum Ltd. v. N.I.O.C.*, all cases in which the arbitrators noted a reference to the general principles of law in order to reach their conclusions as to the internationalization of th.e contract.

It should be noted that the invocation of the general principles of law does not occur only when the municipal law of the contracting State is not suited to petroleum problems. Thus, for example, the Iranian law is without doubt particularly well suited for oil concessions but this does not prevent the contracts executed by Iran from referring very often to these general principles. The recourse to general principles is to be explained not only by the lack of adequate legislation in the State considered (which might have been the case at one time, in certain oil Emirates). It is also justified by the need for the private contracting party to be protected against unilateral and abrupt modifications of the legislation in the contracting State: it plays, therefore, an important role in the contractual equilibrium intended by the parties.

43. This evolution toward the internationalization of contracts was foreseeable: indeed, in its judgments in the cases relating to the *Serbian and Brazilian Loans* and on the occasion of the examination of the criteria which could be adopted for the determination of the applicable law, the Permanent Court of International Justice laid down a rule of great flexibility:

> The Court which has before it a dispute involving the question as to the law which governs the contractual obligations at issue, can determine what this law is only by reference to the actual nature of these obligations and to the circumstances attendant upon their creation, though it may also take into account the expressed or presumed intention of the Parties. ([1929] P.C.I.J., 5cr. A, No. 20, at 41.)

The three criteria laid down by the Permanent Court of International Justice and derived from the nature of the obligations, the circumstances of their creation and the will of the parties, converge, in the instant case, to reverse the presumption which was established, in another connection, by the judgments of 1929, a 1)resumption to which reference was made already . . . and according to which a State cannot, from the outset, be presumed "to have made the substance of its debt and the validity of the obligations accepted by it in respect thereof, subject to any law other' than its own".

44. Another process for the internationalization of a contract consists in inserting a clause providing that possible differences which may arise in respect of the interpretation and the performance of the contract shall he submitted to arbitration.

Such a clause has a twofold consequence:

> – on the one hand, as this Tribunal has already noted . . . the institution of arbitration shall be that established by international law.
>
> – on the other hand, as regards the law applicable to the merits of the dispute itself, the inclusion of an arbitration clause leads to a reference to the rules of international law.

Even if one considers that the choice of international arbitration proceedings cannot by itself lead to the exclusive application of international law, it is one of the elements which makes it possible to detect a certain internationalization of the contract. The *Sapphire International Petroleum Ltd.* award is quite explicit: "If no positive implication can be made from the arbitral clause, it is possible to find there a negative intention, namely to reject the exclusive application of Iranian law" (35 Intl. L.R. 136 (1963), at 172); this is what led the arbitrator in that case, in the absence of any explicit reference to the law applicable, not to apply automatically Iranian law, thus dismissing any presumption in its favor. It is therefore unquestionable that the reference to international arbitration is sufficient to internationalize a contract, in other words, to situate it within a specific legal order–the order of the international law of contracts.

45. (c) A third element of the internationalization of the contracts in dispute results from the fact that it takes on a dimension of a new category of agreements between States and private persons: economic development agree-merits (*see* Bourquin, *Arbitration and Economic Development Agreements*, 15 BUS. LAW. 860 (1960); A. A. FATOUROS, GOVERNMENT GUARANTEES TO FOREIGN INVESTORS (1962); Hyde, *Economic Development Agreements*, 105 RECUEIL DES COURS DE L'ACADÉMIE DE DROIT INTERNATIONAL DE IA HAYE ("R.C.A.D.I.") 267 (1962), and Verdross, *The Status of Foreign Private Interests Stemming from Economic Development Agreements with Arbitration Clauses*, in SELECTED READINGS ON PROTECTION BY LAW OF PRIVATE FOREIGN INVESTMENTS 117 (1964)).

Several elements characterize these agreements: in the first place, their subject matter is particularly broad: they are not concerned only with an isolated purchase or performance, but tend to bring to developing countries investments and technical assistance, particularly in the field of research and exploitation of mineral resources, or in the construction of factories on a turnkey basis. Thus, they assume a real importance in the development of the country where they are performed: it will suffice to mention here the importance of the obligations assumed in the case under consideration by the concession holders in the field of road and port infrastructures and the training on the spot of qualified personnel. The party contracting with the State was thus associated with the realization of the economic and social progress of the host country.

In the second place, the long duration of these contracts implies close cooperation between the State and the contracting party and requires permanent installations as well as the acceptance of extensive responsibilities by the investor.

Finally, because of the purpose of the cooperation in which the contracting party must participate with the State and the magnitude of the investments to which it agreed, the contractual nature of this type of agreement is reinforced: the emphasis on the contractual nature of the legal relation between the host State and the investor is intended to bring about an equilibrium between the goal of the general interest sought by such relation and the profitability which is necessary for the pursuit of the task entrusted to the private enterprise. The effect is also to ensure to the private contracting party a certain stability which is justified by the considerable investments which it makes in the country concerned. The investor must in particular be protected against legislative uncertainties, that is to say the risks of the municipal law of the host country being modified, or against any government measures which would lead to an abrogation or rescission of the contract. Hence, the insertion, as in the present case, of so-called stabilization clauses: these clauses tend to remove all or part of the agreement from the internal law and to provide for its correlative submission to *sui generis* rules as stated in the *Aramco* award, or to a system which is properly an international law system. From this latter point of view, the following considerations should be noted, which were mentioned in the *Sapphire* award, and which stress the interest of the internationalization of the contract:

> Such a solution seems particularly suitable for giving the guarantees of protection which are indispensable for foreign companies, since these companies undergo very considerable risks in bringing financial and technical aid to countries in the process of development. It is in the interest of both parties to such agreements that any disputes between them should be settled according to the general principles universally recognized and should not be subject to the particular rules of national laws. . . . (35 Intl. LR. 136 (1963), at 175-176.) . . .

70. It is therefore necessary to examine in the light of these principles whether the nationalization measures decreed by the Libyan Government with respect to the plaintiffs disregard any specific commitment undertaken by that Government, a commitment which should have been sufficient to protect the plaintiffs from such a decision.

The Deeds of Concession entered into by the parties do not include any provision by which the Libyan Government limited its recourse to nationalization. However, Clause 16 of the Deeds of Concession contains a stabilization clause with respect to the rights of the concession holder. As consideration for the econoniic risks to which the foreign contracting parties were subjected, the Libyan State granted them a concession of a minimum duration of 50 years and, more specifically, containing a non~aggravation clause, Clause 16 which provided:

> The Government of Libya will take all steps necessary to ensure that the company enjoys all the rights conferred by this concession. The contractual rights expressly created by this concession shall not be altered except by mutual consent of the parties.

Another paragraph was added to this provision under the Royal Decree of December 1961 and became an integral part of the contract on the basis of the Agreement of 1963. It provides:

> This Concession shall throughout the period of its validity be construed in accordance with the Petroleum Law and the Regulations in force on the date of execution of the agreement of amendment by which this paragraph (2) was incorporated into the concession agreement. Any amendment to or repeal of such Regulations shall not affect the contractual rights of the Company without its consent.

71. Such a provision, the effect of which is to stabilize the position of the contracting party, does not, in principle, impair the sovereignty of the Libyan State. Not only has the Libyan State freely undertaken commitments but also the fact that this clause stabilizes the petroleum legislation and regulations as of the date of the execution of the agreement does not affect in principle the legislative and regulatory sovereignty of Libya. Libya reserves all its preroga. tives to issue laws and regulations in the field of petroleum activities in respect of national or foreign persons with which it has not undertaken such a commitment. Clause 16 only makes such acts invalid as far as contracting parties are concerned–with respect to whom this commitment has been undertaken–during the period of applicability of the Deeds of Concession. Any changes which may result from the adoption of new laws and regulations must, to affect the contracting parties, he

agreed to by them, This is so not because the sovereignty of Libya would be reduced, but simply by reason of the fact that Libya has, through an exercise of its sovereignty, undertaken commitments under an international agreement, which, for its duration, is the law common to the parties.

Thus, the recognition by international law of the right to nationalize is not sufficient ground to empower a State to disregard its commitments, because the same law also recognizes the power of a State to conimit itself internation. ally, especially by accepting the inclusion of stabilization clauses in a contract entered into with a foreign private party. . . .

NOTES AND QUESTIONS

1. Does the award reflect the probable original intentions of the parties?

2. If you were now representing a host government in drafting a concession agreement, what changes might you consider in the arbitral submission or choice of law clauses used in *TOPCO*?

3. Is the concept of "internationalization" a wise one? What are the implications of internationalization? What should be the prerequisites for the internationalization of a contract? For a case setting in a somewhat different context a very loose standard, see *Revere Copper and Brass v. OPIC*, 17 INT'L LEG. MAT. 1321 (1978).

4. How would or should an award like this be enforced? Should a national court regard it as equivalent to a final award? Would you read the concession. under U.S. law, as creating a waiver of immunity for the purposes of the Foreign Sovereign Immunity Act? For a U.S. example, see *Ipitrade International, S.A. v. Federal Republic of Nigeria*, 465 F. Supp. 824 (D.D.C. 1978); for a French analogue, see *Procureur de la République v. S.A. Sociêté LIAMCO*, 106 JOURNAL DU DROIT INTERNATIONAL 857 (Trib. gr. inst. 1979); and in Switzerland, review the decision of the Federal Supreme Court in *Libya v. Libyan American Oil Co.*, reprinted at 20 INT'L LEG. MAT. 151 (Bundesgericht 1980).

5. After reading *TOPCO*, are you more or less sympathetic to the Latin American position? Is the Latin American position feasible only when one is both a substantial host nation for foreign investment and a substantial home nation for such investment? (This kind of reciprocity characterizes the developed nations, which apply among themselves what amounts to the Latin American position.)

6. Why is this dispute settlement and enforcement procedure so different from that that has evolved for international bank loans, described in Chapter XVII, *supra*?

2. ICSID

During the 1960s, the International Bank for Reconstruction and Development (IBRD or World Bank) assisted the negotiation of a convention creating the International Centre for the Settlement of Investment Disputes (ICSID), The World Bank is an international organization created after World War II and working first for the reconstruction of Europe and later for the economic advancement of the developing nations. It viewed the Centre as a way to assist the growth of foreign investment, and therefore economic development, in the developing nations.

The facility it created is actually a framework–a set of arbitration rules and procedures, together with a stand-by panel of arbitrators. Thus, on request, a panel can be convened relatively quickly. The Convention, excerpted below, includes default choice-of-law rules and also includes detailed provisions on the enforcement of its judgments.

At first there were relatively few cases; moreover, very few Latin American nations participated. Some of the few cases, in addition, were pursued very slowly, involving procedural steps over many years. By the beginning of the 1980s, however, decisions were beginning to be published. These include *AGIP Co. v. Popular Republic of the Congo*, 21 INT'L LEG. MAT. 726 (1982); and *Benvenuti et Bonfant v. People's Republic of the Congo*, 21 INT'L LEG. MAT. 740 (1982).

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT, CONVENTION ON THE SETTLEMENT OF INVESTMENT DISPUTES BETWEEN STATES AND NATIONALS OF OTHER STATES

Articles 1, 25-27, 36-37, 41-48, 53-55 (1966)

The Contracting States

Considering the need for international cooperation for economic development, and the role of private international investment therein;

Bearing in mind the possibility that from time to time disputes may arise in connection with such investment between Contracting States and nationals of other Contracting States;

Recognizing that while such disputes would usually be subject to national legal processes, international methods of settlement may be appropriate in certain cases;

Attaching particular importance to the availability of facilities for international conciliation or arbitration to which Contracting States and nationals of other Contracting States may submit such disputes if they so desire;

Desiring to establish such facilities under the auspices of the International Bank for Reconstruction and Development;

Recognizing that mutual consent by the parties to submit such disputes to conciliation or to arbitration through such facilities constitutes a binding agreement which requires in particular tha.t due consideration be given to any recommendation of conciliators, and that any arhitral award be complied with; and

Declaring that no Contracting State shall by the mere fact of its ratification acceptance or approval of this Convention and without its consent be deemed to be under any obligation to submit any particular dispute to conciliation or arbitration,

Have agreed as follows:

CHAPTER 1. INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

Section 1. Establishment and Organization

Article 1

(1)There is hereby established the International Centre for Settlement of Investment Disputes (hereinafter called the Centre).

(2) The purpose of the Centre shall be to provide facilities for conciliation and arbitration of investment disputes between Contracting States and nationals of other Contracting States in accordance with the provisions of this Convention. . . .

CHAPTER II. JURISDICTION OF THE CENTRE

Article 25

(1) The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.

(2) "National of another Contracting State" means:

(a) any natural person who had 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 as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36, but does not include any person who on either date also had the nationality of the Contracting State party to the dispute; and

(b) any juridical person which had 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 and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.

(3) Consent by a constituent subdivision or agency of a Contracting State shall require the approval of that State unless that State notifies the Centre tha.t no such approval is required.

(4) Any Contracting State may, at the time of ratification, acceptance or approval of this Convention or at any time thereafter, notify the Centre of the class or classes of disputes which it would or would not consider submitting to the jurisdiction of the Centre. The Secretary-General shall forthwith transmit such notification to all Contracting States. Such notification shall not constitute the consent required by paragraph (1).

Article 26

Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention.

Article 27

(1) No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have Failed to abide by and comply with the award rendered in such dispute.

(2) Diplomatic protection, for the purposes of paragraph (1), shall not include informal diplomatic exchanges for the sole purpose of facilitating a settlement of the dispute. . .

CHAPTER IV. ARBITRATION

Section 1. Request for Arbitration

Article 36

(1) Any Contracting State or any national of a Contracting State wishing to institute arbitration proceedings shall address a request to that effect in writing to the Secretary-General who shall send a copy of the request. to the other party.

(2) 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.

(3) The Secretary-General shall register 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. He shall forthwith notify the parties of the registration or refusal to register.

Section 2. Constitution of the Tribunal

Article 37

(I) The Arbitral Tribunal (hereinafter called the Tribunal) shall be constituted as soon as possible after registration of a request pursuant to Article 36.

(2) (a) The Tribunal shall consist of a sole arbitrator or any uneven number of arbitrators appointed as the parties shall agree.

(b) Where the panics do not agree upon the number of arbitratom and the method of their appointment, the Tribunal shall consist of three arbitrators, one arbitrator appointed by each party arid the third, who shall be the president of the Tribunal, appointed by agreement of the parties.

Section 3. Powers and Functions of the Tribunal

Article 41

(1) The Tribunal shall be the judge of' its own competence.

(2) Any objection by a party to the dispute that that dispute is not within the jurisdiction of the Centre, or for other reasons is not within the competence of the Tribunal, shall be considered by the Tribunal which shall determine whether to deal with it as a preliminary question or to join it to the merits of the dispute.

Article 42

(I) The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law' of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.

(2) The Tribunal may not bring in a finding of *non liquet* on the ground of silence or obscurity of the law.

(3) The provisions of paragraphs (1) and (2) shall not prejudice the power of the Tribunal to decide a dispute *ex aequo et bono* if the parties so agree.

Article 43

Except as the parties otherwise agree, the Tribunal may, if it deems it necessary at any stage of the proceedings,

(a) call upon the parties to produce documents or other evidence, and

(b) visit the scene connected with the dispute, and conduct such inquiries there as it may deem appropriate.

Article 44

Any arbitration proceeding shall be conducted in accordance with the provisions of this Section and, except as the parties otherwise agree, in accordance with the Arbitration Rules in effect on the date on which the parties consented to arbitration. If any question of procedure arises which is not covered by this Section or the Arbitration Rules or any rules agreed by the parties, the Tribunal shall decide the question.

Article 45

(1) Failure of a party to appear or to present his case shall not be deemed an admission of the other party's assertions.

(2) If a party fails to appear or to present his case at any stage of the proceedings the other party may request the Tribunal to deal with the questions submitted to it and to

render an award. Before rendering an award, the Tribunal shall notify, and grant a period of grace to, the party failing to appear or to present its case, unless it is satisfied tliat that patty does not intend to do so.

Article 46

Except as the parties otherwise agree, the Tribunal shall, if requested by a party, determine any incidental or additional claims or counter-claims arising directly out of the subject-matter of the dispute provided that they are within the scope of the consent of the parties and are otherwise within the jurisdiction of the Centre.

Article 47

Except as the parties otherwise agree, the Tribunal may, if it considers that the circumstances so require, recommend any provisional measures which should be taken to preserve the respective rights of either party.

Section 4. The Award

Article 48

(1) The Tribunal shall decide questions by a majority of the votes of all its members.

(2) The award of the Tribunal shall be in writing and shall be signed by the members of the Tribunal who voted for it.

(3) The award shall deal with every question submitted to the Tribunal, and shall state the reasons upon which it is based.

(4) Any member of the Tribunal may attach his individual opinion to the award, whether he dissents from the majority or not, or a statement of his dissent.

(5) The Centre shall not publish the award without the consent of the parties.

Section 6. Recognition And Enforcement of the Award

Article 53

(1) The award shall be binding on the parties and shall not be subject to any appeal or to any other remedy except those provided for in this Conven~ don. Each party shall abide by and comply with the terms of the award except to the extent that enforcement shall have been stayed pursuant to the relevant provisions of this Convention.

(2) For the purposes of this Section, “award” shall include any decision interpreting, revising or annulling such award pursuant to Articles 50, 51 or 52.

Article 54

(1) Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State. A Contracting State with a federal constitution may enforce such an award in or through its federal courts and may provide that such courts shall treat the award as if it were a final judgment of the courts of a constituent state.

(2) A party seeking recognition or enforcement in the territories of a Contracting State shall furnish to a competent court or other authority which such State shall have designated for this purpose a copy of the award certified by the Secretary-General. Each Contracting State shall notify the Secretary-Gezv eral of the designation of the competent court or other authority for this purpose and of any subsequent change in such designation.

(3) Execution of the award shall be governed by the laws concerning the execution of judgments in force in the State in whose territories such execution is sought.

Article 55

Nothing in Article 54 shall be construed as derogating from the law in force in any Contracting State relating to immunity of that State or of any foreign State from execution.

NOTES AND QUESTIONS

1. If you were representing an investor, what advantages and disadvantages would you see in the ICSID procedure as compared with arbitration in the *TOPCO* pattern? As compared with litigation in host nation courts? Litigation in home nation courts? What if you were representing the host nation?

2. How likely, do you think, is it that this arbitration format really does offer the advantages of speed and simplicity? What about possible confidentiality? Expertise?

3. Why, do you think, does the convention apply only when there is specific consent of the parties to the dispute (as opposed to application to any investment dispute between a member nation and a firm from another member nation)? Would you favor extension to all such investment disputes save those specifically excluded?

4. Is the ICSID choice of law provision more or less favorable to the investor than that of *TOPCO*?

5. How would you enforce an award made under ICSID? See, as an example, *Benvenuti & Bonfant v. Government of the People's Republic of the Congo*, 20 INT'L LEG. MAT. 877 (1981).

6. Suppose you represented a foreign government that had consented to submission of a specific dispute to ICSID and the investor sued you in the United States courts. Result? *See Maritime Intl. Nominees Establishment v. The Republic of Guinea*, 693 F.2d 1094 (D.C. Cir. 1982), *cert. denied*, --- U.S. ---, 104 S. Ct. 71 (1983).

B. EXPROPRIATION AND INSURANCE

Expropriation is most likely when a revolutionary government comes to power or when a senous investment dispute cannot be settled by means such as those just described. It is always an intensely political act, comparable to a seizure of church lands, a major nationalization, or a major land reform, This both complicates the application of law and creates an incentive to find alternative ways to control the risk, as through insurance.

1. The Legal and Political Approach to Expropriation

There is an elaborate, but highly contested, body of international law governing expropriation. It is generally assumed that a nation always has the right to expropriate a firm, national or foreign, save perhaps in the presence of a stabilization clause in the founding agreement between the nation and the firm. ‘There may be a limitation that the taking be for public purposes. The most controversial substantive issues go to the duty of compensation, with developed countries (DCs) holding to a standard of "prompt, adequate, and just compensation," while developing or "less developed" countries (LDCs) urge a more flexible standard.

But underlying this dispute, there is a jurisdictional dispute reflected in the Calvo clause concept already discussed at p.[redacted], *supra*. The traditional DC view has been that an expropriation that does not meet proper compensation standards is a violation not only of the rights of the individual investor, but also of the rights of that investor's home state. The private issue, of the type faced by ICSID, becomes an "international tort," to be handled through international diplomatic pressure. It is this diplomatic pressure (once actual gunboat pressure) that LDCs specifically resist, and that is the target of the Calvo clause. That clause, however, has been formally ineffective, for the investor's home state will generally regard the investor's waiver of diplomatic jurisdiction as binding on the investor–but not on its government, which did not accept the waiver.

In practice, these technical legal issues are seldom sharply posed. Home state courts usually rely on such doctrines as act of state and sovereign immunity to avoid consideration of international investment disputes, Thus, although those who have been expropriated often attempt to obtain jurisdiction wherever the expropriating government has assets or the expropriated goods are sold, these efforts are only rarely successful. The compensation issue is almost always blurred. The expropriating state will usually make some form of counterclaim, *e.g*., that the expropriated firm gained its position fraudulently, that it owes back taxes, or that it has allowed its physical assets to deteriorate to the point that they are not worth their accounting value (a number that is itself subject to great dispute). The expropriating state will also usually design a special legal procedure for the expropriation–and the question whether this procedure is fair becomes part of the problem, Moreover, the state is very unlikely to have the hard currency needed to make actual payment even if it wanted to (and this sort of purpose is one that is hard to borrow for!). Hence, the state will probably offer payment in long-term bonds, possibly even with some condition attached, such that the bonds become due only as foreign exchange becomes available to the state.

The diplomatic issues are often blurred as well. Nearly every major international investment dispute ends with a "lump-sum settlement," typically reached years after the expropriation, when tempers have cooled and, very possibly, after governments have changed as well. A lump sum agreement is an arrangement between the investor's home state and the host state in which a compromise amount is recognized and, in form, paid to the investor's state, which may then pay it on to the investor.

In fact, the investor's home state is often the effective source of the funds. Sometimes, as with some of the disputes with Eastern European nations after World War II, the United States "*freezes*" the bank accounts of the foreign state and its nationals, meaning that the funds may not be withdrawn (save sometimes for specified amounts for personal needs). When such a dispute is settled, the settlement is often in the amount of the frozen accounts, which are then unblocked. *See* R. LILLICH AND B. WESTON, INTERNATIONAL CLAIMS: THEIR SETTLEMENT BY LUMP-SUM AGREEMENTS 216-240 (1975). Sometimes, as with the 1941 settlement of Mexican oil expropriation claims, the amount comes at least in part from foreign aid. *See* 5 Dept. State Bull. 399-403 (1941). Sometimes, as with the 1976 Marcona settlement *(see* Gantz, *The Marcona Settlement: New Forms of Negotiation and Compensation for Nationalized Property*, 71 AM. J. INT'L L. 474 (1977)), the home state helps the host state borrow the needed capital. And sometimes, as with the Iranian hostage settlement of 1981, the amount comes in part from frozen assets and in part from the host state itself. The Iranian settlement also included complex escrow procedures to ensure parallel release of the hostages and of the frozen sums. And it included detailed provisions for arbitration of the many specific investor disputes. *See* Michael P. Malloy, *The Iran Crisis: Law Under Pressure*, 1984 WISC. INT'L L.J. 15 (1984) (discussing sanctions and post-sanctions settlement and dispute resolution arrangements).

Such a settlement obviously requires substantial diplomatic interference with normal individual dispute settlement. Thus, although its duty to pay compensation to the investor in settling a major international dispute is not clear, the US. government clearly has the right to freeze property for bargaining chip purposes, to compromise an investor's claim against a foreign government as part of a diplomatic settlement, and even to take a case out of the courts in order to submit it to international dispute settlement procedures. *See, e.g., Dames & Moore v. Regan*, 453 U.S. 654 (1981).

2. Investment Insurance

It is quite understandable that firms would like insurance against the expropriation risk. In the United States such insurance is available through the Overseas Private Investment Corporation (OPIC), a semiautonomous entity created by the Foreign Assistance Act of 1969 as a continuation of an earlier Agency for International Development (AID) program. OPIC provides insurance against losses due to currency exchange controls as wel1 as due to expropriation.

The OPIC insurance system is rather complicated but can be suggested in the following diagram:

agreement

OPIC ← → HOST STATE

↑ ↗

insurance contract dispute

↓ ↙

INVESTOR

The insurance contract between OPIC and the investor provides, for a fee, the actual insurance coverage. Disputes under the contract are to be resolved by arbitration (note that this is arbitration between the investor and the U.S. agency *about* the investment dispute, *not* arbitration between the investor and the host government).

The agreement between OPIC and the host government is required by statute; its fundamental provision is the host government's acceptance of OPIC's claim to subrogation–the right to compensation from the host government for the funds that it has had to pay to the investor. This right is actually exercised; OPIC's predecessor agency in AID, for example, once found itself attempting to operate a textile mill in Nigeria that it had acquired under the terms of a war-risk insurance policy. And similarly, a firm using the exchange control insurance will be expected to give the soft currency that it cannot otherwise convert to the government, which can then use it for embassy housekeeping expenses and, effectively, convert it against the host government's will.

The following text of an agreement on investment guaranties between the United States and the People's Republic of China (PRC) exemplifies the kind of protections the U.S. Government seeks for U.S. investment abroad.

AGREEMENT BETWEEN THE UNITED STATES AND THE PEOPLE'S REPUBLIC OF CHINA ON INVESTMENT GUARANTIES

October 30, 1980, [1980] 32 U.S.T. 4010, T.I.A.S. No. 9924

Article 1

As used herein, the term "Coverage" shall refer to any investment insurance (including reinsurance) against loss from political risk or to any investment guaranty which is issued in accordance with this Agreement by OPIC or by any successor United States Government agency, OPIC and any such successor being hereinafter referred to as the "Issuer" to the extent of its interest as insurer or reinsurer in any Coverage.

Article 2

The procedures set forth in this Agreement shall apply only with respect to Coverage of investments relating to projects or activities approved by the Government of the People's Republic of China.

Article 3

(a) If the Issuer makes payment to any investor under Coverage, the Government of the People's Republic of China shall, subject to the provisions of Article 4 hereof, recognize the transfer to the Issuer of any currency, credits, assets, or investment on account of which payment under such Coverage is made, as well as the succession of the Issuer to any right, title, claim, or cause of action existing, or which may arise, in connection therewith, subject to existing legal obligations.

(b) The Issuer shall assert no greater rights than those of the transferring investor with respect to any interests transferred or succeeded to under this paragraph. The Government of the United States of America does, however, reserve its rights to assert a claim in its sovereign capacity under international law.

Article 4

To the extent that the laws of the People's Republic of China partially or wholly invalidate or prohibit the acquisition from a covered investor of any interest in any property within the territory of the People's Republic of China by the Issuer, the Government of the People's Republic of China shall permit such investor and the Issuer to make appropriate arrangements pursuant to which such interests are transferred to an entity permitted to own such interests under the laws of the People's Republic of China.

Article 5

Amounts in the lawful currency of the People's Republic of China, including credits thereof, acquired by the Issuer by virtue of such Coverage shalt be accorded treatment by the Government of the People's Republic of China no less favorable as to use and conversion than the treatment to which such funds would be entitled in the hands of the covered investor. Such amounts and credits shall be freely available for use by the Government of the United States of America to meet its expenditures in the territory of the People's Republic of China. Such amounts and credits may also be transferred by the Issuer to any person or entity agreed by the Government of the People's Republic of China for use by such person or entity in the territory of the People's Republic of China.

Article 6

(a) Any dispute between the Government of the United States of America and the Government of the People's Republic of China regarding the interpretation of this Agreement or which, in the opinion of one of the Governments, involves a question of public international law arising out of any investment or project or activity relating to such investment for which Coverage has been issued shall be resolved, insofar as possible, through negotiations between the two Governments. If at the end of three months following the request for negotiations the two Governments have not resolved the dispute by agreement, the dispute, including the question of whether such dispute presents a question of public international law, shall be submitted, at the initiative of either Government, to an arbitral tribunal for resolution in accordance with Article 6(b).

(b) The arbitral tribunal for resolution of disputes pursuant to Article 6(a) shall be established and function as follows:

(i) Each Government shall appoint one arbitrator; these two arbitrators shall designate a President by common agreement who shall be a citizen of a third state and be appointed by the two Governments. The arbitrators shall be appointed within two months and the President within three months of the date of receipt of either Government's request for arbitration. If the appointments are not made within the foregoing time limits, either Government may, in the absence of any other agreement, request the Secretary General of the United Nations to make the necessary appointment or appointments, and both Governments agree to accept such appointment or appointments.

(ii) The arbitral tribunal shall base its decision on the applicable principles and rules of public international law. The arbitral tribunal shall decide by majority vote. Its decision shall be final and binding.

(iii) Each Government shall pay the expense of its arbitrator and of its representation in the proceedings before the arbitral tribunal; the expenses of the President and the other cost shall be paid in equal parts by the two Governments. The arbitral tribunal may adopt regulations concerning the costs, consistent with the foregoing.

(iv) In all other matters, the arbitral tribunal shall regulate its own procedures.

Article 7

The two Governments, desiring reciprocity, agree that, in the event the Government of the People's Republic of China is authorized under its laws to issue coverage for investments in any project or activity within the United States of America under a program similar to the investment incentive program to which this Agreement relates, there shall be, upon the request of either Government, an exchange of notes to make applicable, with respect to such investments made in the United States of America, provisions equivalent to those of this Agreement. . . .

NOTES AND QUESTIONS

1. The OPIC program has long been controversial, a controversy reflected in the history of OPIC. The program began with AID; its transfer to OPIC reflected a Nixon administration effort to "privatize" it, an effort that also led to some reinsurance of OPIC's risks with other insurance firms, including the Soviet Union's Black Sea and Baltic Company! The controversy revolves around a number of much broader issues–each of which brings its own constituencies and politics:

(a) Does OPIC in practice favor big business at the expense of small business?

(b) Does it really contribute to economic development or is it merely a help to business?

(c) Does it reach the poorest nations?

(d) Is it needed to help U.S. business compete with other national systems?

(e) Does it encourage the flow of jobs abroad?

(f) And does it encourage or discourage State Department intervention in foreign economic disputes?

2. How does Article 6 of the treaty affect the PRC's liabilities? The investor's rights?

3. Is the international agreement really needed?

4. Would you, as counsel for a host nation, seek to encourage or to discourage a

foreign investor to acquire OPIC insurance?

5. In what ways do the OPIC arbitration decisions affect the expropriating nation? Should the OPIC arbitration doctrines be the same as those of international law?

6. What should OPIC do if an investor appears to have seriously antagonized a government, which then expropriated it? *See International Telephone & Telegraph Sud America v, OPIC*, 13 INT'L LEG. MAT. 1307 (1974).

7. What problems do you see in combining QPIC insurance with ICSJD dispute settlement? Note that a nation's nonpayment of an arbitration award is a typical "event of recovery" under an OPIC insurance contract.

8. Under what circumstances might you use both EXIM and OPIC insurance? Would you choose to do so or would the coverages effectively overlap?

9. How does the incidence of the costs of reimbursing expropriated U.S. investors differ depending on whether or not OPIC insurance is used? (Note that this question becomes even more complex if the tax effects of an unreimbursed loss are considered along with the estimates of likely lump-sum settlement terms with and without investment Insurance.)

10. If you were in the State Department, what would you tell a complaining investor who might have acquired OPIC insurance but didn't and then took the loss?

11. Do you think a global investment insurance system is likely to he widely approved? For a current program, see World Bank: [draft] Convention Establishing the Multilateral Investment Guarantee Agency, Seoul, Oct. 11, 1985, *reprinted in* 24 INT'L LEG. MAT. 1598 (1985).

12. Would a global investment insurance system be wise? What are the arguments each way?

13. Is labor's concern with OPIC well founded? Suppose it were clear that there really was a subsidy involved?

14. Recognizing that it is somewhat late for dealing with the debt problems of the mid-1980s, would investment insurance (national or international) for bank loans be wise?

C. INVESTMENT TREATIES

In the face of all the uncertainties involving international investment, a number of states, including the United States, have been working to negotiate networks of "bilateral investment treaties." These treaties vary in detail, but generally require each nation to give the other's firms either Most-Favored-Nation treatment or the equivalent of national treatment, frequently restrict the kinds of investment control laws that the state may require, may define terms of compensation in the event of expropriation, and typically set up detailed dispute settlement procedures. An example is presented in the Selected Documents Supplement, and is the basis of the following questions.

NOTES AND QUESTIONS

1. After accepting the treaty, would either Panama or the United States be free to enact a law like the Canadian FIRA? To join the Andean Pact? To enact a Vredeling-style law? To enact a domestic content requirement?

2. Under what circumstances would a U.S. court be likely to apply the treaty? Would the treaty have any influence on extension of a U.S. embargo to a Panama subsidiary?

3. Would the treaty help with any of the detailed disputes discussed in the previous chapter?

4. If you were representing a U.S. firm considering an investment in Panama, what provisions, if any, would appear important to you?

5. If you were voting in the U.S. Senate, would you support or oppose the treaty? Why? What if you were playing a similar role in Panama?

6. Why, do you think, would Panama accept such a treaty?

7. Should there be a single global treaty comparable to this treaty, a sort of GATT for investment? What might its provisions reasonably be?

8. Suppose that in the current negotiations toward an international code of conduct for multinationals some of the LDCs that are particularly oriented toward economic development through foreign investment are willing to commit themselves to a clause stating

> Host states hereby recognize international legal duties to expropriate property only for public use, to pay prompt, adequate, and just compensation, and not to discriminate against foreign investors in such expropriations.

In return for this commitment, which reflects the goals of some developed world nations, several such nations are willing to make the code of conduct legally binding in international law. Might such. a compromise be wise?

9. Suppose several mutually sympathetic nations were to coordinate their efforts against an expropriating government. What might they wisely do?

10. Why is the United States so much more sympathetic to this approach than to the global code of conduct approach?

11. For other treaty examples, see the Panama-Switzerland Treaty of October 19, 1983, 22 INT'L LEG. MAT. 1255 (1983) and the Asian-African Legal Consultative Committee, *Models for Bilateral Agreements on Promotion and Protection of Investments*, 23 INT'L LEG. MAT. 237 (1984). BITs frequently include provisions for dispute settlement before the ICSID. The following decision illustrates the application of such a treaty to an investment dispute.

MTD EQUITY SDN. BHD. AND MTD CHILE S.A. v. REPUBLIC OF CHILE

ICSID Case No. ARB/01/7 (May 25, 2004)
reprinted in 44 INT'L LEG. MAT. 91 (2005)

I. Procedure

1. Registration of the Request for Arbitration

1. By letter of June 26, 2001, MTD Equity Sdn ("MTD Equity"), a Malaysian company, and MTD Chile S.A ("MTD Chile"), a Chilean company, (collectively "the Claimants"or "MTD") filed a request for arbitration with the International Centre for Settlement of Investment Disputes ("ICSID" or "the Centre") against the Republic of Chile ("the Respondent" or "Chile"). The request invoked the ICSID Arbitration provisions of the 1992 Agreement between the Government of Malaysia and the Government of the Republic of Chile for the Promotion and Protection of Investments ("the BIT"). . . .

3. On July 17, 2001, the Centre requested further information from the Claimants, with regard to the fulfillment by both Claimants of the requirement set forth in Articles

6(3)(i) and (ii) of the BIT concerning an attempt to resolve the dispute amicably through consultation and negotiation at least three months before the request for arbitration. The Centre also sought confirmation from the Claimants that neither of them had submitted the dispute to courts or administrative tribunals of Chile, as precluded by Article 6(3)(ii) and (iii) of the BIT; and that the majority of the shares in the second Claimant, MTD Chile were, for purposes of Article 6(2) of the BIT, owned by investors of Malaysia before the dispute arose. The Claimants responded by a letter of July 30, 2001. . . .

2. Constitution of the Arbitral Tribunal and Commencement of the Proceeding

5. There were two successive arbitral tribunals in this case, the present Tribunal having been appointed upon the joint resignation of the first set of arbitrators [who notified the parties that they would not be able to serve on the basis of the fees agreed by the parties and that each of its members would be resigning his appointment]. . . .

4. Written and Oral Procedure

18. At the first session of the first Tribunal on May 29, 2002, it was agreed that the proceeding would be in English and Spanish. Documents filed in one language would be followed within five business days by a translation in the other language. The procedural arrangements agreed by the first Tribunal have been adhered to by the Tribunal. . . .

II. The Facts

. . .

40. In 1994 Dato[1] Nik of MTD visited Chile as a member of a trade delegation organized by the Malaysian Ministry of Public Works. During this visit, he met with government officials and business leaders who emphasized Chile's encouragement of foreign investment. Dato Nik so reported to the Management Committee of MTD. He also met with Mr. Musa Muhamad, the Malaysian External Trade Commissioner in the Malaysian embassy in Santiago, who encouraged MTD to invest in Chile.

41. In April 1996, Dato Nik heard from Mr. Muhamad about "an opportunity to build a large planned community near Santiago." Dato Nik informed Dato Azmil Khalid who at the time was traveling in the United States. Dato Azmil Khalid traveled directly from the United States to Chile to investigate this opportunity. There he met with Messrs. Muhamad and Antonio Arenas, a local businessman. They informed Dato Khalid that they had found "the perfect location for a planned community."

42. Dato Khalid visited the site in the small town of Pirque and met with the owner of the land, Mr. Jorge Fontaine Aldunate. Mr. Fontaine is reported to have said that "he would like to work with MTD to build a mixed-use planned community on the Malaysian model". Although the site was zoned for agricultural use, Mr. Fontaine is alleged to have said that the land was unproductive and "could readily be rezoned, particularly if it would attract foreign investment."

43. Dato Khalid returned to Malaysia and reported to MTD's Management Committee about this opportunity in Chile. The Management Committee decided to investigate it further. For this purpose, Messrs. Lee Leong Yow (Vincent Lee), MTD's Group General Manager and Head of Operations, and Nazri Shafiee, expert in land valuation, traveled to Chile from May 14 to May 18, 1996. Dato Nik was also in Chile on May 16-17, 1996. He visited the project site and met with Mr. Fontaine and his family.

44. Messrs. Lee and Shafiee visited the Foreign Investment Commission (FIC) on May 16, 1996. There they met with Mr. Joaquin Morales Godoy, Senior Legal Counsel.

1. "Dato" is a Malaysian title of honor.

The next day, Mr. Shafiee met with Mr. Fernando Guerra Francovich, the head of Servicio de Vivienda y Urbanizacion ("SERVIU"). After these meetings, Messrs. Lee and Shafiee concluded that MTD should pursue the investment opportunity and so reported to MTD's Management Committee. Based on their report, the Management Committee decided "to pursue negotiations with Mr. Fontaine while continuing to study the feasibility of a joint venture to develop the Project."

45. MTD engaged Banco Sud Americano in Santiago to appraise the land. In September 1996, the appraisers submitted their report valuing the land of Mr. Fontaine, 3000 hectares, at $34,385,487. The appraisal assumed that the land could be developed as an upscale community after changing the existing zoning for agricultural use.

46. In September 1996, the negotiations of MTD with Mr. Fontaine appeared to have reached a dead end because of disagreement on which hectares to develop and the control of the joint venture: Mr. Fontaine wanted: (i) to develop all 3000 hectares while MTD wished to develop first the 600 located at the lowest elevations; and (ii) a 50/50 split of the equity while for MTD it was essential to have control.

47. Negotiations resumed in November 1996. The law firm Vial & Palma represented MTD, specifically attorneys Alberto Labbe Valverde and Jose Miguel Olivares. The parties prepared a "Promissory Contract" dated as of November 21, 1996.

48. On November 6, 1996, according to the Respondent, a meeting took place between Mr. Edmundo Hermosilla, Minister of MINVU, Mr. Sergio Gonzalez Tapia, Secretario Regional Ministerial ("SEREMI"), and representatives of MTD. That this meeting took place, who attended and what was said at the meeting is a matter of controversy between the parties.

49. In December 1996, Messrs. Dato Azmil Khalid and Lee negotiated the documents implementing the Promissory Contract and signed them on December 13, 1996. The Promissory Contract would take effect only after FIC's approval of the MTD's investment and provided for: (i) development of the land at first in two tranches of 600 and 630 hectares, the second tranche at the option of MTD; and (ii) the creation of a Chilean corporation, "El Principal Inversiones S.A." ("EPSA"), to be owned 51 per cent by MTD Chile S.A. and 49 per cent by Mr. Fontaine.

50. On December 13, 1996, after signature of the Promissory Contract, Dato Khalid and Mr. Labbe met with Mr. Eduardo Moyano, Executive Vice President of the FIC.

51. On January 14, 1997, MTD filed an application with the FIC for approval of an initial investment of US$ 17.136 million. The application described the project as follows:

> "[D]evelop a township of 600 hectares of Fundo El Principal de Pirque, which will be a self-sufficient satellite city, with houses, apartments for diverse socioeconomic strata, schools, hospitals, universities, supermarkets, commerce of all sorts, services, and all other components necessary for self-sufficiency."

52. The application specified the location as "Pirque, Metropolitan Region" and that "the investment would provide initial capital to a newly formed corporation named MTD Chile S.A., which would use the capital to acquire a 51 percent stake in El Principal S.A., which would own the land and develop the Project."

53. The application was approved by the FIC at its session of March 3, 1997. The following members of FIC attended: the President of FIC (the Minister of Economy, Development and Reconstruction), the President of the Central Bank, the Undersecretary of Finance, the Undersecretary of Mining, and the Undersecretary of Planning and

Cooperation. The FIC informed MTD of the approval by letter dated March 6, 1997 and enclosed the standard contract used by Chile for these purposes.

54. The Foreign Investment Contract was signed on March 18, 1997 by the President of FIC on behalf of Chile and Mr. Labbe on behalf of MTD. The Foreign Investment Contract provides that MTD will develop "a real estate project on 600 hectares of Fundo El Principal de Pirque. The aforementioned project consists of the construction of a self-sufficient satellite city, with houses, apartments, schools, hospitals, commerce, services, etc." ("the Project").

55. After signature of the Foreign Investment Contract, MTD injected US$ 8.4 million into EPSA as a capital contribution and with US$ 8.736 million MTD purchased 51% of the EPSA shares from Mr. Fontaine "who was receiving them in return for his contribution to EPSA of 600 hectares of land." The funds contributed by MTD came from the resources of the MTD group and US$ 12 million from a loan made to MTD by the Arab-Malaysian Bank in Kuala Lumpur.

56. In March 1997, MTD representatives met three architectural firms of Santiago "to assist in the design work, performing engineering studies and obtaining regulatory approvals": Darraidou, Larrain & Uranga (DLU), San Martin & Pascal and URBE. In April 1997, MTD selected DLU "to assist in obtaining zoning changes, subdividing the land, and designing prototype models of the houses and other structures." According to the Claimant, all three firms confirmed that the process to change the zoning would need to be initiated by the Municipality of Pirque and the change would need to be endorsed by the Ministry of Housing and Urban Development ("MINVU").

57. MTD submitted a second application to FIC on April 8, 1997 for approval to invest additional working capital of US$ 364,000. The second application was approved by FIC and MTD informed by letter dated April 22, 1997. The letter of approval enclosed the form of the standard foreign investment contract. The contract for this additional investment was signed on May 13, 1997. Its second clause provides that the investment will be used "[t]o make capital contributions and/or increases to the Chilean receiving company called MTD Chile S.A., which is developing a real estate project on 600 hectares of the Fundo El Principal de Pirque."

58. On April 22, 1997, representatives of MTD and Mr. Labbe met with Messrs. Alberto Carbacho Duarte, the MINVU architect with overall responsibility for the Southern region of Santiago, which includes Pirque, and Mr. Sergio Lepe Corvalan, an official in the same office. According to the Claimants, Messrs. Carbacho and Lepe explained that "because Pirque was covered by the Plano Regulador Metropolitano de Santiago (PMRS) [...] the MINVU would need to coordinate and approve the necessary zoning changes for the Project... the review process would be handled at the MINVU by the Secretario Regional Ministerial (SEREMI)."

59. On May 16, 1997, representatives of MTD met with the Mayor of Pirque, Mr. Manuel Jose Ossandon.

60. On May 20, 1997, Dato Azmil Khalid met with Minister Edmundo Hermosilla. The same day, the MTD team met with Mr. Ricardo Lagos Escobar, then Minister of Public Works.

61. The Mayor of Pirque formally endorsed the Project by a letter dated August 14, 1997 and offered his assistance in obtaining approvals.

62. During this period, Minister Hermosilla was replaced by Mr. Sergio Henriquez Diaz.

63. On September 29, 1997, at an official state dinner on the occasion of the visit of the Prime Minister of Malaysia to Chile, President Eduardo Frei Ruiz-Tagle of Chile

delivered a toast making reference, inter alia, to "the innovative real estate project in Pirque." . . . The next day appearance of the President at the inauguration of the Project was cancelled because of an alleged meeting with the President of Brazil. According to the Respondent, the speech to be read by the President, that was already in the hands of the Claimants, was withdrawn. This fact is contested by the Claimants.

64. Around November, 1997, "MTD heard from its consultants that SEREMI Gonzalez of the MINVU was showing reluctance about modifying the PMRS for Pirque."

65. On December 12, 1997, the Diario Oficial published the approval of the modification of the PMRS to include the Chacabuco area, North of Santiago, in order to permit its development under the system of Zonas de Desarrollo Urbano Condicionado ("ZDUCs").

66. In early 1998, MTD engaged the services of Mr. Pablo Heilenkotter, an attorney with expertise in land use regulation and real estate development. Since SEREMI Gonzalez was unwilling to initiate the process to change the zoning, Mr. Heilenkotter and other consultants considered other alternatives under the Ley General de Urbanismo y Construccion ("LGUC"): "(i) the preparation of a sectional plan limited to a modification for the zoning in the area of the Project; (ii) the preparation of a communal plan for the Municipality of Pirque that would also include a zoning change for the area of the Project; and (iii) an application under article 55 for the construction of housing to complement a pre-existing activity."

67. Mr. Heilenkotter met with Mr. Lepe on March 6, 1998, and two weeks later with Mr. Gonzalez together with other consultants of MTD. According to the Claimants, Mr. Gonzalez informed them that he did not wish to undertake another modification to the PMRS "because it had just been changed in December 1997 to incorporate the Chacabuco area."

68. As MTD understood the LGUC, it was possible to pursue a change by way of a sectional plan and the Consejo Regional de la Region Metropolitana ("CORE") would "ultimately decide whether to approve the sectional plan, and it could do so over the MINVU's objection."

69. At this point, the Mayor of Pirque proposed to the Municipal Council to prepare a sectional plan to obtain a change in zoning. The Council approved such approach and the Mayor informed EPSA on March 31, 1998.

70. On April 13, 1998, MTD representatives and consultants met with Mr. Quintana, the CORE President. He suggested that, since Pirque did not have a Communal Regulatory Plan, the Municipality should submit with its sectional plan a strategic plan outlining Pirque's anticipated growth.

71. Sometime in April 1998, Dato Azmil Khalid met with FIC Executive Vice-President Moyano "to discuss the slow progress of the zoning change request". Mr. Moyano reportedly said that he would make inquiries.

72. On April 16, 1998, the Mayor of Pirque, and MTD representatives and consultants met with Mr. Sergio Gonzalez who informed them that the Project was inconsistent with MINVU's urban development policy. After the meeting, the Mayor wrote to SEREMI Gonzalez asking for "guidance about presenting a sectional plan to the MINVU for the development of the Project."

73. On April 20 1998, Mayor Ossandon requested a meeting with the new MINVU Minister, Mr. Henriquez. The meeting took place on May 6, 1998 and it was also attended by representatives and consultants of MTD.

74. The SEREMI's office responded to the letter of April 16 on June 3, 1998 and

explained: that "it would be inconvenient to initiate any changes to the PMRS pending completion of studies aimed at revising the Plan Regional de Desarrollo Urbano (PRDU)"; that "a sectional plan could not be used to obtain a change in zoning for the Project because only the SEREMI could initiate changes to the PMRS"; and that "before the investment contracts were signed, Minister Hermosilla had informed Mr. Fontaine and the Malaysian businessmen that it would not be possible to develop the Project in Pirque."

75. At the request of MTD and as a consequence of the letter of June 3, another meeting with Minister Henriquez took place on June 12, 1998. The Minister endorsed the letter of SEREMI Gonzalez and confirmed that the MINVU would "neither initiate nor support any modification to the PMRS that would allow the Project to proceed."

76. The same day, Mr. Heilenkotter met with Mr. Banderas of the FIC who informed him that "the FIC could not assist MTD and that its role is strictly limited to approving the inflow of foreign investment funds into Chile". At the request of Mr. Labbe, another meeting took place with Messrs. Moyano and Banderas. Mr. Moyano confirmed at the meeting that the approval of the FIC was without prejudice to other necessary approvals and that the FIC's authority was limited to the approval of the flow of funds into the country.

77. The Council of the Municipality of Pirque approved the Sectional Plan on July 3, 1998 and the Mayor submitted it to the SEREMI of MINVU on August 11, 1998. On September 8, 1998, the Mayor also submitted an Environmental Impact Study ("EIS") to the Comision Regional del Medio Ambiente, Region Metropolitana ("COREMA"). On September 15, 1998, the COREMA informed the Municipality that it would review the EIS and announced the review in a public statement.

78. MTD's representatives held meetings with Mr. Jose Miguel Insulza, Minister of Foreign Affairs, who suggested that the Malaysian Government write him and President Frei requesting assistance to address MTD's situation. The Minister of Foreign Affairs of Malaysia wrote to Mr. Insulza and the Malaysian Prime Minister to President Frei on September 11 and September 15, 1998, respectively.

79. On September 25, 1998, the SEREMI of the MINVU returned the sectional plan to the Mayor of Pirque without evaluating the plan on its merits. The letter of SEREMI Gonzalez indicated that "only the SEREMI could change the PRMS, that doing so would be 'inconvenient', and that a sectional plan could not be used to modify the PMRS."

80. On October 19, 1998, MTD's representatives and their advisors met with the MINVU Minister, Mr. Henriquez, and SEREMI Gonzalez. Mr. Henriquez re-affirmed that the policy of the Government was to encourage development of Santiago towards the North and not the South where Pirque is located. Hence, he would not support the required zoning change, and the Project should be built elsewhere in Chile. On October 27, 1998, Mr. Shafiee sent Mr. Henriquez a letter thanking him for the meeting and including draft minutes of the meeting. The Minister responded on November 4, 1998 formally rejecting the Project. He stated that the SEREMI of the MINVU "will not initiate a change to the Regulating Plan for the Santiago Metropolitan Region to make this project possible". In a press release of the same day, MINVU indicated that it had rejected the Project because it conflicted with existing urban development policy and that the Mayor of Pirque no longer supported the Project.

81. On November 26, 1998, the COREMA rejected the EIS because the sectional plan was incompatible with the existing zoning for the land. . . .

83. On June 2, 1999, MTD notified the Respondent that an investment dispute existed under the Malaysia-Chile Bilateral Investment Treaty (the BIT). At the end of the

three-month negotiation period required by the BIT before the dispute may be brought to arbitration, no solution to the dispute had been found. At the request of the Respondent, the parties agreed to a 30-day extension of the negotiation period. Negotiations continued without an agreement being reached at the expiry of the extension.

84. On September 9, 1999, a third Foreign Investment Contract was signed between Chile and MTD for the purpose of providing an additional US$ 25,000 of working capital to MTD Chile. As stated in the Memorial, "The third Contract was executed after the State of Chile had announced that the Project was incompatible with its urban-development policy and does not reference the Project in Pirque."

85. On October 8, 1999, MTD informed representatives of the Respondent that it would pursue this matter in formal dispute settlement proceedings under the auspices of ICSID. MTD continued to meet with representatives of the Respondent until it filed the request for arbitration in June 2001.

III. Preliminary Considerations

1. Applicable Law

86. Article 42(1) of the Convention . . . requires the Tribunal to "decide a dispute in accordance with such rules of law as may be agreed by the parties". This being a dispute under the BIT, the parties have agreed that the merits of the dispute be decided in accordance with international law. Applicable law has not been a matter of controversy between the parties except as it pertains to the issue of whether the Respondent has failed to meet its obligations, under the Foreign Investment Contracts, to grant the necessary permits for the Claimants to carry out their investment in Chile. The Claimants argue that the alleged failure of the Respondent has to be considered under international law because Article 3(1) of the Bilateral Investment Treaty between Chile and Denmark (the "Denmark BIT") has the effect of internationalizing the obligations of the Respondent under the Foreign Investment Contracts. The Respondent denies that Article 3(1) of the Denmark BIT had such effect and maintains that Chilean law applies on the basis of Article 42(1) of the Convention. The Respondent affirms that, in the absence of agreement between the parties, "The applicable law in regard to the foreign investment contracts is Chilean domestic legislation, according to the provisions of the Washington Convention."

87. At this point, the Tribunal will limit itself to note that, for purposes of Article 42(1) of the Convention, the parties have agreed to this arbitration under the BIT. This instrument being a treaty, the agreement to arbitrate under the BIT requires the Tribunal to apply international law. The Tribunal will analyze further this issue when considering the effect of Article 3(1) of the Denmark BIT.

2. Significance of an Investment Dispute

88. At the beginning of its Counter-Memorial, Chile has made statements and provided statistics in support of Chile as "a place to invest". Indeed, between 1974 and 2001, US$ 82.9 billion in foreign investment were authorized, and more than four thousand companies invested in Chile. Chile has also pointed out that the case before the Tribunal is the first time that foreign investors appear before ICSID claiming that Chile violated DL 600[55] and engaged in discriminatory practices.

89. The Tribunal, in noting the success of the Respondent in attracting foreign investment, wishes to record its understanding that a dispute before an ICSID Tribunal

55. Decree Law 600, the Foreign Investment Law of the Republic of Chile.

is not necessarily a black mark on the record of a country or an investor. Bilateral investment treaties are relatively new and it is not unreasonable that their application or the many factors that affect foreign investment be a source of disagreement. The fact that disagreements are brought to the decision of a third party, such as an ICSID arbitral tribunal, and that a country has offered to do so in a treaty strengthens rather than detracts from a country's endeavor to attract foreign investment and treat investors fairly and equitably.

3. Jurisdiction . . .

92. Article 6(1) of the BIT provides:

> "Each Contracting Party consents to submit to the International Centre for the Settlement of Investment Disputes [...] any dispute arising between that Contracting Party and an investor of the other Contracting Party which involves: (i) an obligation entered into by that Contracting Party with the investor of the other Contracting Party regarding an investment by such investor, or (ii) an alleged breach of any right conferred or created by this Agreement with respect to an investment by such investor."

93. MTD Equity is a "national of another Contracting State": it is a corporation organized under the laws of Malaysia and has its seat and operations in Malaysia. It is also an "investor" under the terms of Article 1(c)(ii) of the BIT, which defines investor as including: "any corporation, partnership, trust, joint venture, organization, association or enterprise incorporated or duly constituted in accordance with applicable laws of that Contracting Party and have their seat and operations in the territory of that same Contracting Party."

94. MTD Chile is wholly owned by MTD Equity and is a corporation organized under the laws of Chile. Under Article 25(2)(b) of the ICSID Convention and Article 6(2) of the BIT, such a corporation is to be deemed as a Malaysian national for purposes of arbitration proceedings under the ICSID Convention.

95. The dispute between the parties qualifies as a dispute under each of the categories of Article 6(1) of the BIT. It involves an obligation entered into by the Respondent with the Claimants regarding their investment in Chile and an alleged breach of their rights under the BIT in respect of such investment. . . .

4. The Right of States to adopt Policy and enact Legislation

98. The Tribunal concurs with statements made by the Respondent to the effect that it has a right to decide its urban policies and legislation. Indeed, the States parties to the BIT have agreed that their commitment to encourage and create favorable conditions for investors and admit their investments is "subject to [each party's] rights to exercise powers conferred by its laws, regulations and national policies." Furthermore, in the definition of investment, the term "investment" is understood to refer to "all investments approved by the appropriate Ministries or authorities of the Contracting Parties in accordance with its legislation and national policies."

99. Thus, by entering into the BIT, the Contracting Parties did not limit the exercise of their authority under their national laws or policies except to the extent that this exercise would contravene obligations undertaken in the BIT itself. An arbitral tribunal in the specific case of ICSID would not consider the policies or legislation of a country and changes thereto unless a connection can be established with the investment concerned. This connection may be "established if those general measures are adopted in violation of specific commitments given to the investor in treaties, legislation or contracts. What is brought under the jurisdiction of the Centre is not the general

measures in themselves but the extent to which they may violate those specific commitments."[59]

5. The Most-Favored-Nation (MFN) Clause

100. The Claimants have based in part their claims on provisions of other bilateral investment treaties and have alleged that these provisions apply by operation of the MFN clause of the BIT. The Respondent has not argued against the application of these provisions but, in the case of Article 3(1) of the Denmark BIT and Article 3(3) and (4) of the bilateral investment treaty between Chile and Croatia ("the Croatia BIT"), the Respondent has qualified its arguments by stating that, even in the event that the clause concerned would apply, the facts of the case are such that it would not have been breached. Because of this qualification . . . the Tribunal considers it appropriate to examine the MFN clause in the BIT and satisfy itself that its terms permit the use of the provisions of the Denmark BIT and Croatia BIT as a legal basis for the claims submitted to its decision.

101. The first paragraph of the MFN clause of the BIT–(Article 3(1))–reads as follows:

> "1. Investments made by investors of either Contracting Party in the territory of the other Contracting Party shall receive treatment which is fair and equitable, and not less favourable than that accorded to investments made by investors of any third State."

102. The other provisions of this Article extend the clause to compensation related to losses suffered because of wars or like events or limit its application by excluding benefits provided in regional cooperation and taxation related agreements.

103. The question for the Tribunal is whether the provisions of the Croatia BIT and the Denmark BIT which deal with the obligation to award permits subsequent to approval of an investment and to fulfillment of contractual obligations, respectively, can be considered to be part of fair and equitable treatment.

104. The Tribunal considers the meaning of fair and equitable treatment below and refers to that discussion. The Tribunal has concluded that, under the BIT, the fair and equitable standard of treatment has to be interpreted in the manner most conducive to fulfill the objective of the BIT to protect investments and create conditions favorable to investments. The Tribunal considers that to include as part of the protections of the BIT those included in Article 3(1) of the Denmark BIT and Article 3(3) and (4) of the Croatia BIT is in consonance with this purpose. The Tribunal is further convinced of this conclusion by the fact that the exclusions in the MFN clause relate to tax treatment and regional cooperation, matters alien to the BIT but that, because of the general nature of the MFN clause, the Contracting Parties considered it prudent to exclude. A contrario sensu, other matters that can be construed to be part of the fair and equitable treatment of investors would be covered by the clause.

IV. Considerations on The Merits

105. The Claimants allege that the Respondent has breached:

> (i) Articles 2(2) and 3(1) of the BIT and Article 4(1) of the Croatia BIT by treating their investment unfairly and inequitably;
> (ii) Article 3(1) of the Denmark BIT by breaching the Respondent's obligations under

59. *CMS Gas Transmission Company v. The Republic of Argentina*. Case No. ARB/01/8. Decision on Jurisdiction, para. 27.

the Foreign Investment Contracts;

(iii) Article 3(2) and (4) of the Croatia BIT by impairing through unreasonable and discriminatory measures the use and enjoyment of the Claimants' investment and by failing to grant the necessary permits to carry out an investment already authorized; and

(iv) Article 4 of the BIT by expropriating their investment.

106. The alleged breaches of the Denmark and Croatia BITs are based on the MFN clause of the BIT. The Tribunal will now consider each of these claims and the allegation made by the Respondent that the Claimants acted irresponsibly and contrary to the prudent and diligent standard of behavior expected from an experienced investor.

1. Fair and equitable treatment

107. Article 2(2) of the BIT requires that "Investments of investors of either Contracting Party shall at all time be accorded fair and equitable treatment [...] " The Croatia BIT provides that the right to fair and equitable treatment shall "not be hindered in practice" (Article 4(1)). There is no dispute between the parties about the applicability of these provisions, but they disagree on key facts to determine whether the standard of fair and equitable treatment has been breached. They also disagree on the significance of actions taken by the Respondent in relation to the approval of the investment and the execution of the Foreign Investment Contracts, and the significance of the conduct of the Claimants in reaching and executing their decision to invest in Chile.

108. The parties appear to agree on the meaning of fair and equitable treatment, but in view of comments made by them in the memorials, the Tribunal will address this matter first and then will consider the facts underlying the Claimants' submission for purposes of applying this standard of treatment.

(i) Meaning of "fair and equitable treatment"

109. The parties agree that there is an obligation to treat investments fairly and equitably. The parties also agree with the statement of Judge Schwebel that "the meaning of what is fair and equitable is defined when that standard is applied to a set of specific facts" As defined by Judge Schwebel, "fair and equitable treatment" is "a broad and widely-accepted standard encompassing such fundamental standards as good faith, due process, nondiscrimination, and proportionality".

110. The parties have commented on whether the fair and equitable standard is part of customary international law or additional to customary international law in reference to recent awards of arbitral tribunals established under NAFTA before and after the interpretation of Article 1105(1) by the NAFTA Free Trade Commission. The Free Trade Commission has interpreted "fair and equitable treatment" as not requiring treatment in addition to or beyond that which is required by the international law minimum standard.

111. The Tribunal notes that Chile has not argued that this is how "fair and equitable treatment" should be understood under the BIT. Chile has simply drawn attention to this interpretation and the consequences it had on the application of the standard of fair and equitable treatment by NAFTA arbitral tribunals. The Tribunal further notes that there is no reference to customary international law in the BIT in relation to fair and equitable treatment.

112. This being a Tribunal established under the BIT, it is obliged to apply the provisions of the BIT and interpret them in accordance with the norms of interpretation established by the Vienna Convention on the Law of the Treaties, which is binding on the State parties to the BIT. Article 31(1) of the Vienna Convention requires that a treaty be "interpreted in good faith in accordance with the ordinary meaning to be given to the

terms of the treaty in their context and in the light of its object and purpose."

113. In their ordinary meaning, the terms "fair" and "equitable" used in Article 3(1)[62] of the BIT mean "just", "even-handed", "unbiased", "legitimate".[63] These terms are also used in Article 2(2) of the BIT entitled "Promotion and Protection of Investments".[64] As regards the object and purpose of the BIT, the Tribunal refers to its Preamble where the parties state their desire "to create favourable conditions for investments by investors of one Contracting Party in the territory of the other Contracting Party", and the recognition of "the need to protect investments by investors of both Contracting Parties and to stimulate the flow of investments and individual business initiative with a view to the economic prosperity of both Contracting Parties". Hence, in terms of the BIT, fair and equitable treatment should be understood to be treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment. Its terms are framed as a pro-active statement–"to promote", "to create", "to stimulate"–rather than prescriptions for a passive behavior of the State or avoidance of prejudicial conduct to the investors.

114. Faced with a similar task, the tribunal in *TECMED* described the concept of fair and equitable treatment as follows:

> "[...] to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. 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 investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations. The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the state that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the state to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of its investment without the required compensation."[65]

115. This is the standard that the Tribunal will apply to the facts of this case. The facts or their significance are controversial and the Tribunal will first describe the allegations of the parties as they relate to them.

(ii) Allegations of the Parties

[The Claimants argued that the Respondent had breached the fair and equitable treatment provisions of the BIT and the Croatia BIT when it "created and encouraged strong expectations that the Project, which was the object of the investment, could be

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62. Article 3(1): "Investments made by investors of either Contracting Party in the territory of the other Contracting Party shall receive treatment which is fair and equitable, and not less favourable than that accorded to investments made by investors of any third State."

63. The Concise Oxford Dictionary of Current English, fifth edition.

64. Article 2(2): "Investments of investors of either Contracting Party shall at all time be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Contracting Party."

65. *Tecnicas Medioambientales TECMED S.A. v. The United Mexican States*, ICSID Case No. ARB(AF)00/2, award dated May 29, 2003, para. 154. *See also Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, para. 98.

built in the specific proposed location and entered into a contract confirming that location, but then disapproved that location as a matter of policy after MTD irrevocably committed its investment to build the Project in that location." Furthermore, to the extent that, as alleged by MINVU, the Respondent was always opposed to the Project even before the signing of the Foreign Investment Contracts, then the Respondent acted "duplicitously and in bad faith, for at that time–according to the MINVU's argument–the State of Chile had already made a decision to block the Project." The Respondent disputed these allegations by referring to meetings the Claimants had with Government officials and by questioning the significance attributed by the Claimants to the approval of their investment by the FIC. The Respondent placed great significance on the November 6, 1996 meeting with Minister Hermosilla and SEREMI Gonzalez, but the Claimants denied that the meeting ever took place.

[The Respondent maintained that the Claimants were informed about the difficulty of achieving a change in the PMRS, that the SEREMI of MINVU had the initiative to propose such a change, and that a sectional plan was not the proper vehicle to change the PMRS because it is an instrument hierarchically lower from a normative point of view. It also alleged that the role of the FIC was only to approve the capital transfer and not the details of the project itself, hence the limited nature of the description of the purpose of the investment. The Foreign Investment Contracts guarantee the foreign investor the same treatment as a national investor and provide that the authorization to import capital into Chile is "without prejudice to any others which, pursuant to such laws and regulations must be granted by the competent authorities." Therefore, the Foreign Investment Contracts required "MTD to obtain zoning permits, environmental approvals and other applicable authorizations relating to the Project." The Respondent argued that the claims of Chile's extra-contractual liability "betray a fundamental misunderstanding of the FIC approval process and other provisions of Chilean law", and contested even the existence of a possibility of extra-contractual liability: If a contract existed, "a claim may only be brought alleging the contractual breach; an additional claim alleging quasi-contractual liability is inadmissible."

[The Claimants argued that the warnings that MTD allegedly received from architects, urban planners and government officials after signing the first Foreign Investment Contract would have come too late. It was only in 1998 that the Claimants were informed about the supposed meeting of November 6, 1996, and that the approval of the investment application only meant that MTD could import funds and that Chilean officials first began to raise environmental concerns. Further, in the description of the Project in the application to the FIC and the Second Clause of the contract, which are essentially the same, the project and its location were clearly identified and the contract stated that the purpose of the investment was exclusive and could only be modified with the prior authorization of FIC.

[The Claimants argued that, if "the role of the FIC were simply to approve the inflow of funds (as opposed to approving an investment for a particular project), then it would have been unnecessary and illogical for DL 600: (i) to provide that a Minister who is not a permanent member of the FIC is nevertheless a member for purposes of considering applications that are relevant to that Ministry's work; and (ii) to require the Executive Vice President of the FIC to coordinate with other government agencies concerning information and authorizations." Furthermore, the Respondent was obliged to ensure under article 15(a) of the DL 600 that the FIC coordinates and consults with Ministries concerned.

[The Respondent countered by arguing that the Claimants could not excuse their failure to comply with the law by alleging ignorance of the law. The law was clear, the plot of land in the Fundo El Principal was exclusively for silvoagropecuario use and the foreign investment contracts grant investors only the authorizations provided therein. In contrast, MTD never had any right to carry out its Project, which was always contingent on the obtaining of the relevant authorizations by means of the procedure established by law. MTD did not understand, or did not want to understand, the regulations in force.]

149. From these allegations, three key issues emerge: the significance of the November 6, 1996 meeting, the scope of the approval by the FIC, and the conduct of the Claimants as diligent investors. The Tribunal will now consider them in that sequence.

(iii) The November 6, 1996 meeting

150. The Respondent has attributed particular importance to the meeting allegedly held with "Malaysian businessmen" on November 6, 1996 in order to show the reckless behavior of the Claimants in proceeding to invest notwithstanding warnings of the obstacles that their investment would face. The Claimants contest that such meeting ever took place. As proof of that meeting, there is the word "Malaysia" in the calendar of Minister Hermosilla and reference made to the meeting in two documents of the Respondent dated two years later. There are no briefings prior to the meeting, nor written record of what was discussed, nor any contemporaneous written record of who attended the meeting. Neither Minister Hermosilla nor SEREMI Gonzalez could determine whether any of the MTD representatives who attended the hearings in Washington were one of the "Malaysian businessmen" that allegedly attended the November 6, 1996 meeting. . . .

[Given the factual controversy surrounding the meeting, the Tribunal analyzed the situation “with and without the meeting.” The Tribunal concluded on this issue as follows.]

158. The Claimants' own actions contradict also the allegation of what was said at the November 6 meeting assuming that it took place. Irrespective of the inconsequent business decisions taken notwithstanding the alleged clear warnings of the Respondent, a matter to which the Tribunal will turn later, the Claimants, in their dealings with Mr. Fontaine, sought protection in respect of the approval of their investment by the FIC. They conditioned the taking effect of the Promissory Contract to the FIC's approval of the transfer of funds. It would seem reasonable to assume that, if the statements made to them by Minister Hermosilla and SEREMI Gonzalez had been as clear as alleged, the Claimants would have protected themselves accordingly by looking for another site or canceling the proposed investment altogether. It would have been equally inconsequential for the Claimants to seek the FIC's approval for an investment considered unfeasible by high level officials of the Respondent. . . .

159. The scope of the approval of the first two investments of the Claimants by the FIC is a key element in the consideration of whether the Respondent fulfilled its obligation to treat the Claimants fairly and equitably and the Tribunal will turn to this question now. At this point, the Tribunal is only concerned with the actual approval of the inflow of funds for the Project and with the fact that Chile entered into the Foreign Investment Contracts with the Claimants. . . .

(iv) Significance of the Approval of the FIC

160. The parties disagree on the meaning of the approval of the investment by the FIC under DL 600 and the significance of the absence of the Minister responsible for the sector of the proposed investment from the meeting where the investment was approved. . . .

162. DL 600 confers on the FIC the power to approve on behalf of "the Chilean State

the inflow of foreign capital under this Decree-Law and to stipulate the terms and conditions of the corresponding contracts" (Article 12). The FIC members are all at the ministerial level except for the president of the Central Bank (Article 13). Decisions are taken by simple majority and a quorum for a meeting requires only the presence of any three members (Article 14). In order for the FIC to exercise its functions, the Executive Vice-Presidency is responsible, inter alia, for the coordination of foreign investments and to carry out and expedite the procedures required by public institutions that must report or grant their authorization prior to the approval of the applications submitted to the FIC (Article 15). The applications require the investor to specify the location of the investment and the requirement is repeated in the nonnegotiable standard foreign investment contract. It is this contract that, in terms of DL 600, evidences the authorization of the FIC (Article 3). A change in the location of the investment would require a change in the contract and hence, the approval of the FIC.

163. The Tribunal considers that the ministerial membership of the FIC is by itself proof of the importance that Chile attributes to its function, and it is consequent with the objective to coordinate foreign investment at the highest level of the Ministries concerned. It is also evident from the DL 600 that the FIC is required to carry out a minimum of diligence internally and externally. Approval of a Project in a location would give prima facie to an investor the expectation that the project is feasible in that location from a regulatory point of view. The practice whereby the non-permanent member of the FIC is not notified of the FIC meetings and no information is distributed to the Minister concerned prior to the meetings, when followed consistently, may impair seriously the coordination function of the FIC. This is not to say that approval of a project in a particular location entitles the investor to develop that site without further governmental approval. The Foreign Investment Contracts are clear in that respect and this matter is dealt with separately in this award. What the Tribunal emphasizes here is the inconsistency of action between two arms of the same Government vis-a-vis the same investor even when the legal framework of the country provides for a mechanism to coordinate. This is even more so, if, as affirmed by the Respondent, the presence of the MINVU Minister in the FIC meeting where the investment was approved would not have made a difference. . . .

165. . . . Chile . . . has an obligation to act coherently and apply its policies consistently, independently of how diligent an investor is. Under international law (the law that this Tribunal has to apply to a dispute under the BIT), the State of Chile needs to be considered by the Tribunal as a unit.

166. The Tribunal is satisfied, based on the evidence presented to it, that approval of an investment by the FIC for a project that is against the urban policy of the Government is a breach of the obligation to treat an investor fairly and equitably. In this respect, whether the meeting of November 6, 1996 took place or not does not affect the outcome of these considerations. In fact, if it did take place, it is even more inexplicable that the FIC would approve the investment and the first two Foreign Investment Contracts would be signed. Minister Hermosilla and the FIC were different channels of communication of the Respondent with outside parties, but, for purposes of the obligations of Chile under the BIT, they represented Chile as a unit, as a monolith, to use the Respondent's term. . . .

(v) The issue of the Claimants' diligence

168. The lack of diligence of the Claimants alleged by the Respondent rests on the trust placed in Mr. Fontaine, the lack of adequate professional advice in the urban sector and the acceptance of an exorbitant land valuation at the time they made the investment.

. . .

175. The Claimants decided on the value of the land only on the basis of that appraisal without considering the specific value of the 600 hectares that would be the basis of the initial investment, or how the value of the land was affected by the existing road system, or applicable zoning restrictions. According to the Respondent, if a more "exacting land appraisal" had been conducted, the Claimants, would have discovered that the value of the 600- hectare area proposed for development under the Project was between US$ 4.1 and US$ 4.6 million.

176. It is clear from the record that no specialist in urban development was contacted by the Claimants until the deal had been closed. The firms contacted thereafter, to the extent that there is a contemporary written record, do not seem to have been as clear as they are now in their testimony about the difficulty of changing the zoning. The only thing that emerges with certainty is that the Claimants were in a hurry to start the Project.

177. The Claimants apparently did not appreciate the fact that Mr. Fontaine may have had a conflict of interest with the Claimants for purposes of developing El Principal. He played lightly to them the significance of the zoning changes and they seem to have accepted at first hand Mr. Fontaine's judgment. The price paid for the land was based on the Project going ahead and it was paid up-front without any link to the progress of the Project.

178. The BITs are not an insurance against business risk[139] and the Tribunal considers that the Claimants should bear the consequences of their own actions as experienced businessmen. Their choice of partner, the acceptance of a land valuation based on future assumptions without protecting themselves contractually in case the assumptions would not materialize, including the issuance of the required development permits, are risks that the Claimants took irrespective of Chile's actions.

2. Breach of the BIT by Breach of the Foreign Investment Contracts . . .

187. The Tribunal considers the legal basis of the claim valid based on the wide scope of the MFN clause in the BIT. . . . The Tribunal notes the statement of the Respondent that under international law the breach of a contractual obligation is not *ipso facto* a breach of a treaty. Under the BIT, by way of the MFN clause, this is what the parties had agreed. The Tribunal has to apply the BIT. The breach of the BIT is governed by international law. However, to establish the facts of the breach, it will be necessary to consider the contractual obligations undertaken by the Respondent and the Claimants and what their scope was under Chilean law.

188. The Tribunal has found that Chile treated unfairly and inequitably the Claimants by authorizing an investment that could not take place for reasons of its urban policy. The Claimants have based their arguments on the fact that "the location of the Project was a fundamental assumption of the bargain between MTD and the State of Chile. MTD had a right to that location, and the State of Chile had a correlative obligation to take such steps as might be necessary to permit the use of that location for the development of the Project." The Tribunal accepts that the authorization to invest in Chile is not a blanket authorization but only the initiation of a process to obtain the necessary permits and approvals from the various agencies and departments of the Government. It also accepts that the Government has to proceed in accordance with its

139. "the Tribunal must emphasize that Bilateral Investment Treaties are not insurance policies against bad business judgments." Emilio Agustin Maffezini v. The Kingdom of Spain, ICSID Case No. ARB/97/7 para. 69.

own laws and policies in awarding such permits and approvals. Clause Four of the Foreign Investment Contracts would be meaningless if it were otherwise. Therefore, the Tribunal finds that Chile did not breach the BIT on account of breach of the Foreign Investment Contracts.

189. . . . [W]hat is unacceptable for the Tribunal is that an investment would be approved for a particular location specified in the application and the subsequent contract when the objective of the investment is against the policy of the Government. Even accepting the limited significance of the Foreign Investment Contracts for purposes of other permits and approvals that may required, they should be at least in themselves an indication that, from the Government's point of view, the Project is not against Government policy.

3. Unreasonable and Discriminatory Measures

190. The argument of the Claimants regarding unreasonable and discriminatory measures is based on Article 3(3) of the Croatia BIT. This Article provides:

> "Each Contracting Party shall protect within its territory investments made in accordance with its laws and regulations by investors of the other Contracting Party and shall not impair by unreasonable or discriminatory measures the management, maintenance, use, enjoyment, extension, sale and liquidation of such investments."

196. To a certain extent, this claim has been considered by the Tribunal as part of the fair and equitable treatment. The approval of an investment against the Government urban policy can be equally considered unreasonable. On the other hand, the changes of the PMRS related to Chacabuco or more recently Modification 48, as explained by the Respondent, do not dispense with specific changes of the PMRS when the land is zoned of "silvoagropecuario interest". Therefore, there is no basis for considering the modifications made to PMRS as discriminatory. The Tribunal is also satisfied by the explanation regarding the rejection of the EIS by COREMA.

4. Failure to Grant Necessary Permits

197. This claim is based on the Croatia BIT by way of the MFN clause of the BIT. Article 3(2) of the Croatia BIT reads as follows: "When a Contracting Party has admitted an investment in its territory, it shall grant the necessary permits in accordance with its laws and regulations." . . .

204. The Tribunal considers the legal basis of the claim valid based on the wide scope of the MFN clause in the BIT, as already discussed. The Tribunal disagrees with the Respondent's statement that there is no merit to the contention of the Claimants that, if there is a breach of an international obligation, "the matter is governed, first and foremost, by international law". The breach of an international obligation will need, by definition, to be judged in terms of international law. To establish the facts of the breach, it may be necessary to take into account municipal law. In the instant case, the Tribunal will need to establish first whether the Respondent's failure to modify the PMRS to the benefit of the Claimants was in accordance with its own laws.

205. The Tribunal draws a distinction between permits to be granted in accordance with the laws and regulations of the country concerned and those actions that require a change of said laws and regulations. To the extent that the application for a permit meets the requirements of the law, then, in accordance with the BIT and Article 3(2) of the Croatia BIT, the investor should be granted such permit. On the other hand, said provision does not entitle an investor to a change of the normative framework of the country where it invests. All that an investor may expect is that the law be applied.

206. . . . [T]he carrying out of the investment would have required a change in the norms that regulate the urban sector in Chile. The PMRS forms part of this normative framework, as repeatedly stated by the Respondent. Laws and regulations may be changed by a country but it is not an entitlement that can be based in Article 3(2) of the Croatia BIT. This clause is an assurance to the investor that the laws will be applied, and to the State a confirmation that its obligation under that article is confined to grant the permits in accordance with its own laws. The Tribunal concludes that the Respondent did not breach the BIT by not changing the PMRS as required for the Project to proceed.

5. Expropriation . . .

214. As already stated, the Tribunal agrees with the argument of the Respondent that an investor does not have a right to a modification of the laws of the host country. As argued by the Respondent, "every State has the power to amend any of its laws. The mere fact that Chile can change the PMRS does not mean, however, that Chile is obligated to do so." The issue in this case is not of expropriation but unfair treatment by the State when it approved an investment against the policy of the State itself. The investor did not have the right to the amendment of the PMRS. It is not a permit that has been denied, but a change in a regulation. It was the policy of the Respondent and its right not to change it. For the same reason, it was unfair to admit the investment in the country in the first place.

V. Damages

238. The Tribunal first notes that the BIT provides for the standard of compensation applicable to expropriation, "prompt, adequate and effective" (Article 4(c)). It does not provide what this standard should be in the case of compensation for breaches of the BIT on other grounds. The Claimants have proposed the classic standard enounced by the Permanent Court of Justice in the *Factory at Chorzow*: compensation should "wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that had not been committed." The Respondent has not objected to the application of this standard and no differentiation has been made about the standard of compensation in relation to the grounds on which it is justified. Therefore, the Tribunal will apply the standard of compensation proposed by the Claimants to the extent of the damages awarded.

1. Eligible Expenditures

239. The Tribunal considers that the Claimants have proven that the expenditures related to the Project were made by them or on their behalf and that they were made for purposes of the investment in Chile.

240. The Tribunal considers as eligible for purposes of the calculation of damages the following expenditures:

(i) Expenditures related to the initial investment in the amount of US $ 17,345,400.00.

(ii) The Tribunal has found that Chile's responsibility is related to the approval of the transfer of funds by the FIC in spite of the policy of the Government not to change the PMRS. Therefore, the Tribunal considers that expenditures for the Project prior to the execution of the first Foreign Exchange Contract on March 18, 1997 are not eligible for purpose of the calculation of damages even if they could be considered part of the investment. For the same reason, expenditures made after November 4, 1998–the date on which Minister Henriquez informed the Claimants in writing that the PMRS would not be changed–are also to be excluded from said calculation. The total of expenditures during this period on account of salaries, travel, legal services and miscellaneous items, as detailed in Exhibit 93A submitted with the Reply, amount to US$ 235,605.37.

(iii) The Tribunal considers the financial costs related to the investment made to be part of a business decision on how to finance the investment. As stated by the tribunal in *Middle East Cement* and referred to by the parties in their allegations: "They could be claimed, if it were shown that they were caused by conduct of the Respondent which was in breach of the BIT." Since the Tribunal has found that Chile breached its obligation to treat the Claimants' investment fairly and equitably and this treatment is related to the decision of the Claimants to invest in Chile, the Tribunal considers that the financial costs related to the investment in the amount of US $ 3,888,582.95 are part of the eligible expenditures for purposes of the calculation of damages.

241. The aggregate of the above eligible expenditures amounts to US $ 21,469,588.32. However, the residual value of the investment and the damages that can be attributed to business risk need to be deducted from such amount. . . .

2. Damages Attributable to Business Risk. Residual value of the Investment

242. The Tribunal decided earlier that the Claimants incurred costs that were related to their business judgment irrespective of the breach of fair and equitable treatment under the BIT. As already noted, the Claimants, at the time of their contract with Mr. Fontaine, had made decisions that increased their risks in the transaction and for which they bear responsibility, regardless of the treatment given by Chile to the Claimants. They accepted to pay a price for the land with the Project without appropriate legal protection. A wise investor would not have paid full price up-front for land valued on the assumption of the realization of the Project; he would at least have staged future payments to project progress, including the issuance of the required development permits.

243. The Tribunal considers therefore that the Claimants should bear part of the damages suffered and the Tribunal estimates that share to be 50% after deduction of the residual value of their investment [calculated by the Tribunal as a cash value on a present value basis of US$ 9,726,943.48].[226] . . .

3. Date from which pre-award interest should accrue

247. The Tribunal considers that interest on the amount of damages for which Chile is responsible should accrue from November 5, 1998, the day after Minister Henriquez notified the Claimants that it was against his Government's policy to modify the PMRS. . . .

4. Applicable Rate of Interest . . .

250. This being an international tribunal assessing damages under a bilateral investment treaty in an internationally traded currency related to an international transaction, it would seem in keeping with the nature of the dispute that the applicable rate of interest be the annual LIBOR on November 5 of each year since November 5, 1998 until payment of the awarded amount of damages. Based on the rates published daily by Bloomberg, the annual LIBOR on November 5 of each year since November 5, 1998 are as follows: (i) 5.03813 % in 1998, (ii) 6.16 % in 1999, (iii) 6.71625 % in 2000, (iv) 2.24625 % in 2001, (v) 1.62 % in 2002, and (vi) 1.4925 % in 2003. . . .

NOTES AND QUESTIONS

226. For purposes of this calculation, the Tribunal has used the US dollar two-year swap rate of May 6, 2004 for a two-year swap effective May 21, 2004 published by Bloomberg. The two-year swap rate represents an interest rate at which semiannual cash flows may be discounted until the maturity of the swap. There are no LIBOR [London Inter-Bank Offering Rate] rates for period of more than one year.

1. Paragraphs 40-84 of *MTD Equity* illustrate some of the practical difficulties involved in negotiating an investment project related to the development policies of a host state. Who were the interested parties in these negotiations? What were their respective interests in the investment? As to the public entities involved in the negotiations, were their interests consistent with each other? In practical terms, what caused the investment dispute?

2. According to ¶ 86 of the decision, "the parties . . . agreed that the merits of the dispute be decided in accordance with international law." Does this mean that the investment arrangement was "internationalized," in the sense that *TOPCO* used the term? What are the consequences for the parties of agreeing that the dispute should be decided in accordance with international law?

3. In invoking international law, the Claimants refer to Article 3(1) of the Bilateral Investment Treaty between Chile and Denmark (the "Denmark BIT"). Since this is a dispute between a Malaysian company and Chile, what is the relevance of the Denmark BIT? (*See* ¶¶ 86, 100, *supra*.)

3. Specifically, what "international law" governs the investment? (*See, e.g.*, ¶¶ 100-104, 110-115, 179, 187, *supra*.) What is the role of Chilean domestic law in this dispute? (*See, e.g.*, ¶ 204, *supra*.)

4. MTD Chile is a corporation organized under the laws of Chile. Is it a Chilean national, and if so, why is this dispute subject to international law? (*See* ¶¶ 92-95, *supra*.) (*Cf*. note 9, *infra*, and the excerpt from the *Loewen Group* decision that follows it.)

5. Does a host state have a right to decide its own urban policies and legislation? If so, does the BIT interfere with that right? What would be the incentive for a host state to subject its policy and law to dispute settlement before the ICSID? (*See* ¶¶ 98-99, *supra*.)

6. What role does the MFN principle play in this dispute? (*See* ¶¶ 100-104, *supra*.)

7. It is of course true that a BIT is not "insurance against business risk" (¶ 178). But how significant is the lack of "diligence"–or perhaps simply the Claimants' inexperience–in light of Chile's failure to treat the Claimants in a fair and equitable manner? (*See* ¶¶ 188-189.)

8. The Tribunal concluded that (*i*) Chile did not breach the BIT on account of breach of the Foreign Investment Contracts (¶ 188); (*ii*) the modifications made to PMRS were not discriminatory (¶ 196); (*iii*) the BIT was not breached by Chile's decision not to change the PMRS as required for the Project to proceed (¶ 206); and, (*iv*) Chile had not expropriated MTD's property (¶ 214). So, what *did* Chile do that resulted in the damages specified in ¶¶ 238-250? What should it have done?

9. Whatever else it might be, the NAFTA is an investment treaty, providing nationals of each of the three states that are parties to it significant protections for their investments in either of the other states, and a dispute settlement process when investment disputes arise. As you will see in the decisions that follow, the ICSID plays a very significant role in that regard. However, as with *MTD*, arising under a BIT (*see* note 4, *supra*), one underlying legal issue is the jurisdiction of the tribunal in light of the nationality of the claimant, an issue that is complicated when the claimant has a corporate personality.

THE LOEWEN GROUP, INC. v. UNITED STATES OF AMERICA

ICSID Case No. ARB(AF)/98/3 (June 26, 2003)
reprinted in 42 INT'L LEG. MAT. 811 (2003)

I. Introduction

1. This is an important and extremely difficult case. Ultimately it turns on a question of jurisdiction arising from (a) the NAFTA requirement of diversity of nationality as between a claimant and the respondent government, and (b) the assignment by the Loewen Group, Inc. of its NAFTA claims to a Canadian corporation owned and controlled by a United States corporation. This question was raised by Respondent's motion to dismiss for lack of jurisdiction filed after the oral hearing on the merits. In this Award we uphold the motion and dismiss Claimants' NAFTA claims.

2. As our consideration of the merits of the case was well advanced when Respondent filed this motion to dismiss and as we reached the conclusion that Claimants' NAFTA claims should be dismissed on the merits. . . . [T]he conclusion rest[ed] on the Claimants' failure to show that Loewen had no reasonably available and adequate remedy under United States municipal law in respect of the matters of which it complains, being matters alleged to be violations of NAFTA.

3. This dispute arises out of litigation brought against first Claimant, the Loewen Group, Inc ("TLGI") and the Loewen Group International, Inc ("LGII") (collectively called "Loewen"), its principal United States subsidiary, in Mississippi State Court by Jeremiah O'Keefe Sr. (Jerry O'Keefe), his son and various companies owned by the O'Keefe family (collectively called "O'Keefe"). The litigation arose out of a commercial dispute between O'Keefe and Loewen which were competitors in the funeral home and funeral insurance business in Mississippi. The dispute concerned three contracts between O'Keefe and Loewen said to be valued by O'Keefe at $980,000 and an exchange of two O'Keefe funeral homes said to be worth $2.5 million for a Loewen insurance company worth $4 million approximately. The action was heard by Judge Graves (an African-American judge) and a jury. Of the twelve jurors, eight were African-American.

4. The Mississippi jury awarded O'Keefe $500 million damages, including $75 million damages for emotional distress and $400 million punitive damages. The verdict was the outcome of a seven-week trial in which, according to Claimants, the trial judge repeatedly allowed O'Keefe's attorneys to make extensive irrelevant and highly prejudicial references (i) to Claimants' foreign nationality (which was contrasted to O'Keefe's Mississippi roots); (ii) race-based distinctions between O'Keefe and Loewen; and (iii) class-based distinctions between Loewen (which O'Keefe counsel portrayed as large wealthy corporations) and O'Keefe (who was portrayed as running family-owned businesses). Further, according to Claimants, after permitting those references, the trial judge refused to give an instruction to the jury stating clearly that nationality-based, racial and class-based discrimination was impermissible.

5. Loewen sought to appeal the $500 million verdict and judgment but were confronted with the application of an appellate bond requirement. Mississippi law requires an appeal bond for 125% of the judgment as a condition of staying execution on the judgment, but allows the bond to be reduced or dispensed with for "good cause."

6. Despite Claimants' claim that there was good cause to reduce the appeal bond, both the trial court and the Mississippi Supreme Court refused to reduce the appeal bond at all and required Loewen to post a $625 million bond within seven days in order to pursue its appeal without facing immediate execution of the judgment. According to Claimants, that decision effectively foreclosed Loewen's appeal rights.

7. Claimants allege that Loewen was then forced to settle the case "under extreme duress." Other alternatives to settlement were said to be catastrophic and/or unavailable. On January 29, 1996, with execution against their Mississippi assets scheduled to start the next day, Loewen entered into a settlement with O'Keefe under which they agreed

to pay $175 million.

8. In this claim Claimants seek compensation for damage inflicted upon TLGI and LGII and for damage to second Claimant's interests as a direct result of alleged violations of Chapter Eleven of the North American Free Trade Agreement ("NAFTA") committed primarily by the State of Mississippi in the course of the litigation.

II. The Parties

9. First Claimant TLGI is a Canadian corporation which carries on business in Canada and the United States. Second Claimant is Raymond Loewen, a Canadian citizen who was the founder of TLGI and its principal shareholder and chief executive officer. TLGI submits claims as "investor of a Party" on its own behalf under NAFTA, Article 1116 and on behalf of LGII under Article 1117. Likewise, Raymond Loewen submits claims as "the investor of a party" on behalf of TLGI under NAFTA, Article 1117.

10. The Respondent is the Federal Government of the United States of America.

III. History of Proceedings in This Arbitration . . .

12. By [a] Decision dated January 5, 2001, the Tribunal dismissed Respondent's objection to competence and jurisdiction so far as it related to the first ground of objection and adjourned the further hearing of Respondent's other grounds of objection and joined that further hearing to the hearing on the merits which was fixed for October 15, 2001. . . .

V. History of the Proceedings since the Decision on Competence and Jurisdiction

. . .

29. Subsequently, on January 25, 2002 Respondent filed the motion to dismiss Claimants' NAFTA claims for lack of jurisdiction, based on the reorganization of TLGI under Chapter Eleven of the United States Bankruptcy Code. An element in that reorganization was the assignment by TLGI of its NAFTA claims to a newly created Canadian corporation, Nafcanco, which was owned and controlled by LGII (re-named "Alderwoods, Inc", a United States corporation). . . .

XXX. Respondent's Additional Objection to Competence and Jurisdiction

220. Subsequent to the October 2001 hearings on the merits, events occurred which raised questions about TLGI's capacity to pursue its NAFTA claims and gave rise to Respondent filing a further objection to competence and jurisdiction on January 25, 2002. TLGI had filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code, and a reorganization plan was approved by the bankruptcy courts of the United States and Canada. Under that plan, TLGI ceased to exist as a business entity. All of its business operations were reorganized as a United States corporation. In apparent recognition of the obvious problem that would be caused by a United States entity pursuing a claim against the United States under NAFTA, TLGI, immediately prior to its going out of business, assigned all of its right, title and interest to the NAFTA claim to a newly created corporation (discreetly called Nafcanco–a play on the words NAFTA and Canada). It would appear that the NAFTA claim is the only asset of Nafcanco, and the pursuit of the claim its only business.

221. Following the filing of Respondent's objection, appropriate pleadings were filed by both sides and on June 6, 2002, the Tribunal held a hearing on the objection. Canada and Mexico . . . submitted their views on the issues that were raised at the hearing.

222. NAFTA is a treaty intending to promote trade and investment between Canada, Mexico and the United States. Since most international investment occurs in the private sector, investment treaties frequently seek to provide some kind of protection for persons engaging in such investment. Until fairly recently, such protection was implemented and pursued by the States themselves. When Mexico expropriated the investment of some

American oil companies many years ago, the claims of the American companies were pursued by American diplomatic authorities. When the United States seized the assets of Iranian nationals during the hostage crisis of the 1970s, Iran and the United States worked out a settlement as sovereign nations.

223. 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.

224. If NAFTA could be used to assert the rights of an American investor in the instant case, it would in effect create a collateral appeal from the decision of the Mississippi courts, by definition a unit of the United States government. . . . [T]he object of NAFTA is to protect outsiders who do not have access to the political or other avenues by which to seek relief from nefarious practices of governmental units.

225. Claimant TLGI urges that since it had the requisite nationality at the time the claim arose, and, antedate the time that the claim was submitted, it is of no consequence that the present real party in interest–the beneficiary of the claim–is an American citizen. Both as a matter of historical and current international precedent, this argument must fail. In international law parlance, there must be continuous national identity from the date of the events giving rise to the claim, which date is known as the dies a quo, through the date of the resolution of the claim, which date is known as the dies ad quem.

226. Claimants' first argument strand is that NAFTA itself, in Articles 1116 and 1117, require nationality only to the date of submission. However, those articles deal only with nationality requirements at the *dies a quo*, the beginning date of the claim. There is no language in those articles, or anywhere else in the treaty, which deals with the question of whether nationality must continue to the time of resolution of the claim. It is that silence in the Treaty that requires the application of customary international law to resolve the question of the need for continuous national identity.

227. Nor does the recent arbitral decision in the *Mondev* case[a] help Claimants in any way. In that case, the Tribunal dealt with the issue of whether the investment itself had to remain of the claimant's identity. Significantly, the reasoning of the Tribunal implicated other sections of NAFTA, namely Articles 1105 and 1110. The investment in *Mondev*, some Boston real estate, had been foreclosed on by an American mortgage holder. Even though it denied Mondev's claim on the merits, the Tribunal appropriately found that the loss of the investment through foreclosure of the mortgage could not be the basis for denying Mondev's right to pursue its remedies under NAFTA. It pointed out that such a set of events could occur quite often to indenters and that the whole purpose of NAFTA's protection would be frustrated if such disputes could not be pursued. It said:

a. *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2 (October 11, 2002), *reprinted in* 42 I.L.M. 85 (2003).

> "Secondly the Tribunal would again observe that Article 1105, and even more so Article 1110, will frequently have to be applied after the investment in question has failed. In most cases, the dispute submitted to arbitration will concern precisely the question of responsibility for that failure. To require the claimant to maintain a continuing status as an investor under the law of the host State at the time the arbitration is commenced would tend to frustrate the very purpose of Chapter 11, which is to provide protection to investors against wrongful conduct including uncompensated expropriation of their investment and to do so throughout the lifetime of an investment up to the moment of its "sale or other disposition" (Article 1101(2)). On that basis, the Tribunal concludes that NAFTA should be interpreted broadly to cover any legal claims arising out of the treatment of an investment as defined in Article 1139, whether or not the investment subsists as such at the time of the treatment which is complained of. Otherwise issues of the effective protection of investment at the international level will be overshadowed by technical questions of the application of local property laws and the classification of local property interests affected by foreclosure or other action subsequent to the failure of the investment."

228. In sum, neither the language of the Treaty, nor any of the cases decided under it answers the question as to whether continuous nationality is required until the resolution of the claim. Respondent correctly contends that Article 1131 requires the Tribunal to decide the issues in dispute in accordance with "applicable rules of international law."

229. There is only limited dispute as to the history of the requirement of continuous nationality to the end of any international proceeding. When investment claims were negotiated and resolved only at a governmental level, any change in nationality of the claimant defeated the only reason for the negotiations to continue. The claiming government no longer had a citizen to protect. This history has changed as the nature of the claim process has changed. As claimants have been allowed to prosecute claims in their own right more often, provision has been made for amelioration of the strict requirement of continuous nationality. But those provisions have been specifically spelled out in the various treaties that TLGI cites as proof that international law has changed. Thus, in the claims settlement agreement between Iran and the United States arising out of the hostage crisis, the requirement of continuous nationality was specifically altered in the agreement. Many of the bilateral investment treaties, the so-called "BITs", contain specific modifications of the requirement. But such specific provisions in other treaties and agreements only hinder TLGI's contentions, since NAFTA has no such specific provision.

230. As with most hoary international rules of law, the requirement of continuous nationality was grounded in comity. It was not normally the business of one nation to be interfering into the manner in which another nation handled its internal commerce. Such interference would be justified only to protect the interests of one of its own nationals. If that tie were ended, so was the justification. As international law relaxed to allow aggrieved parties to pursue remedies directly, rather than through diplomatic channels, the need for a rigid rule of dies ad quem also was relaxed. But as was previously noted, such relaxations came about specifically in the language of the treaties. There is no such language in the NAFTA document and there are substantial reasons why the Tribunal should not stretch the existing language to affect such a change.

231. We address at this stage an aspect of the problem which might well puzzle a private lawyer. Such a lawyer would of course be familiar with the inhibitions which can stand in the way of the enforcement of liabilities when changes in corporate status, or

in the proprietorship of the claims, intervene after the proceedings to enforce the claim have commenced. Insolvency or judicial administration or a moratorium may affect one of the parties so that under the relevant domestic law the liability ceases to be enforceable for a while, or is compulsorily transferred to a third party, or entirely changes its juristic character, or may become a right to share in the proceedings of a winding up. Equally, the lawyer would recognise the potential for difficulties in enforcing a liability after a voluntary transfer to a third party, when the right to pursue the complaint may be enforceable only by the transferee, or only in the name of the transferor for the benefit of the transferee; and he could well foresee that particular difficulties could arise when, under an arbitration agreement between A and B, the former begins an arbitration, and afterwards transfers the right to C, a stranger to the arbitration agreement. These are no more than examples. These procedural difficulties are of a kind which many domestic systems of law have confronted.

232. The same lawyer might well, however, have much more difficulty in visualising the outcome in the quite different situation where, through subsequent events of the kind indicated above, a vested claim, already the subject of valid proceedings, simply ceases to exist, together with the breach of obligation or delict which have brought it into being. True, it is possible to imagine that a change of identity with a consequent change of nationality by the enforcing party might deprive a tribunal of territorial jurisdiction under its domestic rules of procedure. This is not the present case. If the submissions of the United States are right, the fatal objection to success by the Claimants is that a NAFTA claim cannot exist or cannot any longer exist, once the diversity of nationality has come to an end, so that the Tribunal cannot continue with the resolution of the original dispute, there being no dispute left to resolve. The private lawyer might well exclaim that the uncovenanted benefit to the defendant would produce a result so unjust that it could be sustained only by irrefutable logic or compelling precedent, and neither exists. The spontaneous disappearance of a vested cause of action must be the rarest of incidents, and no warrant has been shown for it in the present context.

233. Such a reaction, though understandable, in our opinion, would be, wholly misplaced. Rights of action under private law arise from personal obligations (albeit they may be owed by or to a State) brought into existence by domestic law and enforceable through domestic tribunals and courts. NAFTA claims have a quite different character, stemming from a corner of public international law in which, by treaty, the power of States under that law to take international measures for the correction of wrongs done to its nationals has been replaced by an ad hoc definition of certain kinds of wrong, coupled with specialist means of compensation. These means are both distinct from and exclusive of the remedies for wrongful acts under private law: see Articles 1121, 1131, 2021 and 2022. It is true that some aspects of the resolution of disputes arising in relation to private international commerce are imported into the NAFTA system via Article 1120.1(c), and that the handling of disputes within that system by professionals experienced in the handling of major international arbitrations has tended in practice to make a NAFTA arbitration look like the more familiar kind of process. But this apparent resemblance is misleading. The two forms of process, and the rights which they enforce, have nothing in common. There is no warrant for transferring rules derived from private law into a field of international law where claimants are permitted for convenience to enforce what are in origin the rights of Party states. If the effects of a change of ownership are to be ascertained we must do so, not by inapt analogies with private law rules, but from the words of Chapter Eleven, read in the context of the Treaty as a whole, and of the purpose which it sets out to achieve.

234. TLGI urges some equitable consideration be given because it was the underlying Mississippi litigation which brought about the need for it to file bankruptcy in the first place. . . . But this is an international tribunal whose jurisdiction stems from and is limited to the words of the NAFTA treaty. Whatever the reasons for TLGI's decision to follow the bankruptcy route it chose, the consequences broke the chain of nationality that the Treaty requires.

235. Claimants also seek to rely on provisions of the Convention establishing the International Centre for Settlement of Investment Disputes (ICSID). It claims that under ICSID, there are different nationality rules that should be applied in this case. First, it must be noted that neither Canada nor Mexico are signatories of ICSID and it would be most strange to apply provisions of that Convention to a NAFTA dispute. The only relevance of ICSID to this proceeding is that the Parties have elected to function under its structure. That election cannot be used to change or supplement the substance of the Treaty that the three nations have entered into. Whatever specificity ICSID has on the requirement of continuous nationality through the resolution of the dispute only points up the absence of such provisions in NAFTA. Claimants have not shown that international law has evolved to the position where continuous nationality to the time of resolution is no longer required.

236. TLGI further contends that the International Law Commission issued a report which proposed eliminating the continuous nationality rule even in cases of diplomatic protection, a field that would seem more nationality oriented than the protection of investors. The report itself met with criticism in many quarters and from many points of view. In any event, the ILC is far from approving any recodification based on the report.

237. Article 1109 fully authorizes transfers of property by an investor. TLGI contends that such provision for free assignment somehow strengthens its position. The assignment from TLGI to Nafcanco is not being challenged, except as to what is being assigned. By the terms of the assignment, the only item being assigned was this NAFTA claim. All of the assets and business of TLGI have been reorganized under the mantle of an American corporation. All of the benefits of any award would clearly inure to the American corporation. Such a naked entity as Nafcanco, even with its catchy name, cannot qualify as a continuing national for the purposes of this proceeding. Claimants also urge that TLGI remains in existence, since its charter remains in existence. The Tribunal is being asked to look at form rather than substance to resolve a complicated claim under an international treaty. Even if TLGI has some kind of ethereal existence, it sought to place any remaining NAFTA marbles in the Nafcanco ring. Claimants insist that Respondent is asking the Tribunal to "pierce" the corporate veil of Nafcanco and point out the legal complications involved in such a piercing. The Tribunal sees no need to enter into that thicket. The question is whether there is any remaining Canadian entity capable of pursuing the NAFTA claim.

238. Claimants state that there were good and sufficient business reasons for reorganizing under an American corporate character including pressure from TLGI's creditors. The Tribunal has no reasons to doubt the legitimacy of those reasons but the choices made clearly had consequences under the Treaty. There might have been equally compelling reasons for the Loewen interests to choose a United States mantle when it first commenced doing business. NAFTA does not recognize such business choices as a substitute for its jurisdictional requirements under its provisions and under international law.

239. Raymond Loewen argues that his claims under NAFTA survive the reorganization. Respondent originally objected to Raymond Loewen's claims on the ground that

he no longer had control over his stock at the commencement of the proceeding. The Tribunal allowed Raymond Loewen to continue in the proceeding to determine whether he in fact continued any stock holding in the company. No evidence was adduced to establish his interest and he certainly was not a party in interest at the time of the reorganization of TLGI.

240. In regard to the question of costs the Tribunal is of the view that the dispute raised difficult and novel questions of far-reaching importance for each party, and the Tribunal therefore makes no award of costs. . . .

XXXI. Conclusion

241. We think it right to add one final word. A reader following our account of the injustices which were suffered by Loewen and Mr. Raymond Loewen in the Courts of Mississippi could well be troubled to find that they emerge from the present long and costly proceedings with no remedy at all. After all, we have held that judicial wrongs may in principle be brought home to the State Party under Chapter Eleven, and have criticised the Mississippi proceedings in the strongest terms. There was unfairness here towards the foreign investor. Why not use the weapons at hand to put it right? What clearer case than the present could there be for the ideals of NAFTA to be given some teeth?

242. This human reaction has been present in our minds throughout but we must be on guard against allowing it to control our decision. Far from fulfilling the purposes of NAFTA, an intervention on our part would compromise them by obscuring the crucial separation between the international obligations of the State under NAFTA, of which the fair treatment of foreign investors in the judicial sphere is but one aspect, and the much broader domestic responsibilities of every nation towards litigants of whatever origin who appear before its national courts. Subject to explicit international agreement permitting external control or review, these latter responsibilities are for each individual state to regulate according to its own chosen appreciation of the ends of justice. As we have sought to make clear, we find nothing in NAFTA to justify the exercise by this Tribunal of an appellate function parallel to that which belongs to the courts of the host nation. In the last resort, a failure by that nation to provide adequate means of remedy may amount to an international wrong but only in the last resort. The line may be hard to draw, but it is real. Too great a readiness to step from outside into the domestic arena, attributing the shape of an international wrong to what is really a local error (however serious), will damage both the integrity of the domestic judicial system and the viability of NAFTA itself. The natural instinct, when someone observes a miscarriage of justice, is to step in and try to put it right, but the interests of the international investing community demand that we must observe the principles which we have been appointed to apply, and stay our hands.

NOTES AND QUESTIONS

1. ICSID decisions contain a relatively rich assortment of jurisdictional and related issues. For discussion of, for example, jurisdiction over claims by a U.S. citizen and registered permanent resident of Mexico, time limitations on claims, estoppel or suspension of time limitations, post-filing submission of additional claims, submission of pre-NAFTA-effective date claims, standing, and exhaustion of local remedies, see *Marvin Feldman v. Mexico*, ICSID CASE No. ARB(AF)/99/1 (December 16, 2002) *reprinted in* 42 INT'L LEG. MAT. 625 (2003) (exploring issues under NAFTA).

2. Assume that a concessions agreement between Considerable Corp., a Delaware

corporation, and Nusquam contains a choice-of-forum clause that submits disputes concerning interpretation of the agreement to the Nusquami Commercial Court. Nusquam is also a signatory of the ICSID Convention, and has a BIT with the United States that includes a provision giving nationals of each state the right to seek resolution of investment disputes with the other state through ICSID arbitration. If a dispute arises, and Considerable initiates proceedings under ICSID, can Nusquam successfully object that the dispute must be submitted to the Commercial Court? For an interesting analysis of this problem, see *Compania De Aguas Del Aconquija, S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3 (November 21, 2000), *reprinted in*, 40 INT'L LEG. MAT. 426 (2001) (holding that ICSID tribunal has jurisdiction to hear investor's claims for violation of host state under BIT).

3. Are you satisfied with the tribunal's analysis of the jurisdiction issue? TLGI was a Canadian corporation, and Raymond Loewen is a Canadian citizen. They were the ones injured by the claimed violation of NAFTA Chapter Eleven. Should it matter to the question of jurisdiction that they were forced to sell out their business as a result of the violation?

4. Recall that MTD Chile was a corporation organized under the laws of Chile, and yet the ICSID tribunal allowed it to pursue a claim against Chile. Can you reconcile this decision with the approach taken by the tribunal in *Loewen Group*?

5. Loewen Group says that it was forced to settle the Mississippi case under extreme duress by agreeing to pay O'Keefe $175 million, which eventually resulted in the bankruptcy and sale of the company. Does this not represent an investment loss to Raymond O'Keefe, allegedly in violation of NAFTA? Could Raymond bring proceedings against the United States before ICSID?

6. Review ¶ 237, *supra*. Can you suggest some other way that TLGI might have structured its transfer to Nafcanco that would have enabled TLGI to make a stronger argument under *Mondev*?

MARVIN FELDMAN v. MEXICO

ICSID CASE No. ARB(AF)/99/1 (December 16, 2002)
reprinted in 42 INT'L LEG. MAT. 625 (2003)

A. Introduction and Summary of the Dispute

1. This case concerns a dispute regarding the application of certain tax laws by the United Mexican States (hereinafter "Mexico" or "the Respondent") to the export of tobacco products by Corporacion de Exportaciones Mexicanas, S.A. de C.V. ("CEMSA"), a company organized under the laws of Mexico and owned and controlled by Mr. Marvin Roy Feldman Karpa (hereinafter "Mr. Feldman" or "the Claimant"), a citizen of the United States of America ("United States"). The Claimant, who is suing as the sole investor on behalf of CEMSA, alleges that Mexico's refusal to rebate excise taxes applied to cigarettes exported by CEMSA and Mexico's continuing refusal to recognize CEMSA's right to a rebate of such taxes regarding prospective cigarette exports constitute a breach of Mexico's obligations under the Chapter Eleven, Section A of the North American Free Trade Agreement (hereinafter "NAFTA"). In particular, Mr. Feldman alleges violations of NAFTA Articles 1102 (National Treatment), 1105 (Minimum Level of Treatment), and 1110 (Expropriation and Indemnification). Mexico denies these allegations. . . .

C. The Arbitral Agreement . . .

4. NAFTA Article 1117 entitles an investor to bring a claim against a NAFTA State

Party on behalf of an enterprise of another NAFTA Party which the investor owns or controls. NAFTA Article 1139 provides that an "enterprise of a Party means an enterprise constituted or organized under the law of a [NAFTA] Party."

5. NAFTA Article 1120 provides that arbitral proceedings may be instituted under the Additional Facility Rules of the International Centre for Settlement of Investment Disputes ("ICSID"), as modified by the provisions of Chapter Eleven, Section B of the NAFTA, provided that either the disputing Party whose measure is alleged to be a breach referred to in Article 1117 (in this case, Mexico) or the Party of the investor (in this case, the United States), but not both, is a party to the ICSID Convention. The ICSID Additional Facility Rules, rather than the ICSID Convention, are applicable in this case since only the United States, as the Party of the investor, but not the United Mexican States, as the Respondent in this case, is a Contracting State to the ICSID Convention. Under NAFTA Article 1122(1), in conjunction with NAFTA Articles 1116, 1117 and 1120, Mexico expresses its consent to the submission to arbitration of claims of investors who are nationals of another State Party to the NAFTA either under the ICSID Convention, under the Additional Facility Rules, or under the UNCITRAL Arbitration Rules.

D. Facts and Allegations

6. Much of the complexity of this case results from the parties' disagreements with regard to the facts. The reasons for this are several. First, in some instances, records are not available because they have been destroyed, as records are routinely destroyed at the Mexican Ministry of Finance and Public Credit (Secretaria de Hacienda y Credito Publico, hereinafter "SHCP") after five years. . . . Secondly, there are disagreements to particular facts which the Tribunal cannot rectify on the basis of the material presented, either because the information does not exist or because the Respondent has been unwilling or unable to produce it. As a result, in some instances, the "evidence" presented by both sides results in an assertion of facts rather than proof of facts. This section summarizes what the Tribunal believes to be the key facts and assertions, noting when the "facts" are from a particular party's point of view. They are discussed in more detail in the relevant sections of this award.

7. The case concerns the tax rebates which may be available when cigarettes are exported. Mexico imposes a tax on production and sale of cigarettes in the domestic market under the Impuesto Especial Sobre Produccion y Servicios ("IESP") law, a special or excise tax on products and services. In some circumstances, however, a zero tax rate has been applied to cigarettes that are exported. According to the Respondent, the IEPS Law "has basically remained the same since its origins [in 1981], although the underlying methodology of the tax has changed several times". . . .

8. Under the 1991 IEPS law, certain activities generated liability for the tax, including, *inter alia*, selling domestically, importing and exporting the goods listed in Article 2, section I of the Law. The IEPS law also included the tax rate for each product. In the case of domestic sales and imports of cigarettes, the rates were 139.3% from 1990 through 1994, and 85% from 1995 through 1997 (Article 2). However, the IEPS rate on exports of cigarettes from 1990 through 1997 was 0%. From 1992, only exports to countries that were not considered low income tax jurisdictions (tax havens)–in general, countries with an income tax rate above 30%–were eligible for a 0% rate. In most instances, when cigarettes were purchased in Mexico at a price that included the tax, and subsequently exported, the tax amounts initially paid could be rebated.

9. The Claimant's firm, CEMSA, first began exporting cigarettes in 1990. According to the Respondent, the record shows that SHCP paid the IEPS rebates to the claimant for

1990-1991 in full (including amounts properly owing to inflation and interest) and declined only to pay the demanded "financial costs" for which there was no provision under the Fiscal Code. . . . While the Claimant contended that CEMSA had by 1991 established a cigarette export business, the Respondent alleges that CEMSA's request for IEPS rebates in November 1990-1991 related solely to exports of beer and alcoholic beverages. . . .

10. According to the Claimant, an authorized producer of cigarettes in Mexico, Carlos Slim "protested [regarding Claimant's exports] and the government took administrative steps and passed legislation to cut off rebates to CEMSA in 1991". . . . This assertion is contested by the Respondent. The 1991 legislation was apparently designed to provide IEPS rebates to exports undertaken by producers of cigarettes (such as Cigatam, a firm allegedly controlled by Carlos Slim), but to deny rebates for exports by resellers of cigarettes, such as CEMSA. . . . The amendments to Article 2, Section III in 1991, specified that a 0% rate applied to final exports, under the terms of the customs legislation, by producers and bottlers of the goods, and by foreign trade companies, as well as by persons entering into contracts with producers and bottlers, including for sale abroad, as long as they complied with certain requirements to be issued by SHCP. . . . The Claimant, as a reseller, became ineligible for rebates.

11. The Claimant initiated an Amparo action before the Mexican courts in February, 1991, challenging the constitutional validity of Article 2, Section III, in that it limited the 0% tax rate to producers and bottlers. The Amparo alleged that these measures infringed upon the constitutional principle of "equity of taxpayers" by excluding all other exporters from the possibility of obtaining the 0% rate (counter-memorial, para. 102). In April, 1991, the Fifth District Judge in Administrative Matters dismissed CEMSA's Amparo, in part, but granted it, in part, citing that SHCP had no authority to issue the implementing fiscal regulations for 1991, which CEMSA was challenging. The decision was appealed by both sides in May, 1991. In July, CEMSA also filed a criminal complaint against the SHCP officials responsible for enactment of the 1991 amendment to Article 2 section III of the IEPS Law, for abuse of authority and conspiracy. . . .

12. Pending final resolution of the Amparo, the Mexican Congress amended the IEPS law, effective January 1, 1992, to allow IEPS rebates to all cigarette exporters, and CEMSA was able to export cigarettes with rebates most of that year. Effectively, this new law reverted to the system in force in 1990, making all final exports eligible for application of the 0% rate. . . . As far as the Tribunal is able to determine, the 1992 legislation remained unchanged in all aspects relevant to this case through 1997.

13. According to the Claimant, after the IEPS law was amended in 1992, the Claimant began to export cigarettes. Claimant claims to have received rebates thereafter . . . ; this assertion is neither confirmed nor denied by the Respondent, because the records have been destroyed after five years in accordance with normal SHCP policies. . . .

14. In January, 1993, according to the Claimant, the Respondent shut down CEMSA's cigarette export business for a second time, . . . because the Claimant could not meet other requirements of the IEPS law. . . . The reasons for the Claimant's inability to produce invoices are rather complicated.

15. The IEPS requires cigarette producers to pay the 85% tax, which is then passed on to purchasers in their purchase price. . . . The taxable base is the sales price to the retailer, and further tax is not paid on subsequent sales. . . . To be eligible for the tax rebate, the IEPS tax on the cigarettes must be stated "separately and expressly on their invoices". . . . This is required by Article 4 of the IEPS Law, which applies to all taxes covered by the IEPS, not just taxes on cigarettes. Only producers, and not resellers, have

access to the itemized invoice. CEMSA purchased the cigarettes from volume retailers such as Wal-Mart or Sam's club (rather than the producers), at a price that included the IEPS tax, but was not itemized separately on the invoice. CEMSA thus was never able to obtain invoices separating the tax.

16. In August, 1993, the Supreme Court of Justice ruled in favor of CEMSA, finding unanimously that "measures allowing IEPS rebates only to producers and their distributors violated constitutional principles of tax equity and non-discrimination". . . . The court did not discuss or rule explicitly on any other relevant issues, such as whether the Claimant was entitled to rebates notwithstanding the Claimant's inability to produce invoices stating the tax amounts separately.

17. During the period 1993-1995, the Respondent recognized that CEMSA was a taxpayer entitled to the 0% tax rate on cigarette exports, but continued to demand that the Claimant meet the invoice requirements of Article 4 of the IEPS law, even though it was impossible for CEMSA to meet those requirements.

18. CEMSA claims that Mexican tax officials gave the Claimant "assurances" in 1995-1996 that rebates would be paid . . . and alleges that negotiation of an oral "agreement" took place in 1995, confirmed and finally implemented in 1996, which would permit CEMSA to resume exporting cigarettes in large quantities in June 1996. [T]he Respondent vigorously denies the existence of any such agreement, and asserts that it was complying with the 1993 Supreme Court Amparo decision by affording Claimant access to the 0% tax rate for exports. Neither party was able to produce conclusive evidence of the existence or non-existence of such an agreement or understanding.

19. Regardless of the possible existence or non-existence of an agreement, the Claimant states that he was paid rebates from June 1996 to September 1997, a total of sixteen months. . . . CEMSA claims that during these sixteen months, "Hacienda officials knew that CEMSA was receiving IEPS rebates on cigarette exports without having obtained invoices separating the tax". . . . The Respondent counters by observing that it is standard practice for SHCP to pay requests for rebates promptly as they are submitted, given that they have the authority to audit IEPS tax returns to determine if the requirements of the law have been complied with. According to the Claimant, "by late 1997, CEMSA accounted for almost 15% of Mexico's cigarette exports". . . .

20. However, this situation did not last. The Respondent finally terminated rebates to CEMSA on or before December 1, 1997. According to the Claimant, this was done without prior warning . . . , and the Respondent refused to pay rebates of US $2.35 million owed to CEMSA on exports made in October and November 1997. . . .

21. Since December 1, 1997, the IEPS law has been amended to bar rebates to cigarette resellers such as CEMSA, limiting such rebates to the "first sale" in Mexico. Articles 11 and 19 of the IEPS were amended so as to provide that tax rebates are not allowed on sales subsequent to those made to the retailer. The amendments also imposed an obligation on exporters of certain goods, including cigarettes, of registering in the Sectorial Exporters Registry in order to be entitled to apply for the 0% IEPS rate on exports. Subsequently, under the 1998 amendment, CEMSA was also refused registration as an authorized exporter of cigarettes and alcoholic beverages (memorial, p. 4, see also reply, para. 5). Absent such registration, Mexican Customs authorities will not issue the "pedimento" (export documentation) that is required to export goods from Mexico. The Respondent contends that this refusal was a result of an on-going audit of CEMSA's earlier claims for IEPS tax reimbursements.

22. On July 14, 1998, SHCP began an audit of CEMSA and demanded that CEMSA

repay the approximately US$25 million for IEPS rebates SHCP asserts the Claimant received during the twenty one-month period of January 1996 to September 1997, with interest and penalties. To avoid forfeiture and criminal sanctions for non-payment, CEMSA challenged the "assessment" in the Mexican courts. This assessment proceeding in the Mexican courts remains pending. A separate proceeding, which has been concluded, challenged the Respondent's denial of IEPS rebates for the period October-November 1997.

23. The Claimant is not the only reseller/exporter of cigarettes in Mexico. The Claimant and the Respondent agree that at least two other firms, Mercados I and Mercados II, owned by named Mexican nationals (the "Poblano Group") are resellers of cigarettes in "like circumstances" with CEMSA. . . . The Claimant asserts that these Mexican firms have been permitted to obtain rebates for taxes on exported cigarettes during periods when such rebates have been denied to the Claimant, notwithstanding the inability of these firms to produce the necessary invoices stating the tax amounts separately. The Respondent concedes that at least five companies have been registered as cigarette exporters, but has been unable or unwilling to provide any detailed information on the status of those firms or their access to IEPS tax rebates. The Respondent, however, alleges that the Claimant and the "Poblano Group" belong effectively to the same business entity and, therefore, are not eligible to be compared to each other for national treatment purposes. ...

G. Additional Jurisdictional Issues . . .

G.2 Exhaustion of Local Remedies . . .

67. In essence, the Claimant alleges that NAFTA Chapter 11, and particularly its Section B, was designed to provide investors of the NAFTA Parties with impartial international dispute resolution. A prospective claimant must make an election. If he wants to pursue a damage claim under NAFTA, he has to waive his rights to pursue damages in the local courts. Thus, Mexico traded its traditional position on the exclusive jurisdiction of its courts in exchange for the enormous benefits to be drawn from NAFTA. . . . Accordingly, this Arbitral Tribunal may well examine both Mexican domestic laws and the conduct of Mexican tax authorities to determine whether they meet minimum standards of international law, including due process of law, fair and equitable treatment, and full protection and security, as incorporated by NAFTA Articles 1110(1)(c) and 1131(1). . . . Therefore, an international tribunal reviewing state action under international law may reach a different result than a domestic tribunal reviewing the same conduct under domestic law. The potential difference of results is due to the difference of standards. This could readily happen in a case where the domestic statutory framework was designed to discriminate against the claimant. . . .

68. In addition, the Claimant maintains that both the investor and the investment have waived their right to claim damages in the Mexican courts, as required by NAFTA Article 1121. . . . Whatever proceedings may be pending now in Mexico, they do not constrain the Arbitral Tribunal since (1) under Mexican procedure, the Claimant was required to challenge SHCP's actions in order to avoid seizure of property and, likely, imprisonment; and (2) after this Tribunal was constituted, the Claimant filed papers seeking to terminate all domestic litigation. . . . In sum, the Claimant neither has any effective legal remedy under Mexican law nor can be required to introduce every year a new Amparo procedure in order to meet all annual minor amendments to the IEPS law, no matter how marginal and irrelevant these legislative amendments may be.

69. The Respondent basically denies that the Claimant has any right to receive IEPS rebates as a matter of Mexican law. Subject to constitutional questions, the particular

issue of the requirement of separate and express invoices has been resolved in two separate proceedings before the Mexican courts, which have sole jurisdiction over issues of Mexican law, and is likely to be addressed again in one of the proceedings for an extended period of time. Neither is there any international legal right to IEPS rebates nor is this Arbitral Tribunal authorized to substitute its views of domestic law for those of the local courts. . . . According to the Respondent, the Claimant is having his day in court in Mexico, and in any event, as those proceedings involve issues of Mexican law they are not relevant to this proceeding. Those proceedings would be relevant only if the Claimant were in a position to challenge the Mexican court actions as constituting a denial of justice under international law, which the Claimant has not done. Consequently, it would be incorrect to state that there were an absence of an effective legal remedy just because the Claimant lost in one of the proceedings; at the time of the Respondent's submission, the Claimant appears to be prevailing in the second action, but it is not final. If that were true, every disappointed litigant who otherwise met the standing requirements of NAFTA Chapter Eleven, Section B, would bring a claim under international law. . . . The Respondent concludes therefore that, with the exception of the claim for an alleged denial of national treatment, all of the claims advanced in this proceeding would require the Arbitral Tribunal to apply domestic law in the place of the proper judicial body. . . .

G.3 Analysis

71. The decision on the issue of exhaustion of local remedies as a condition for claim admissibility primarily depends on the wording and construction of the relevant NAFTA provisions. Indeed, it is generally understood that the local remedies rule may be derogated from, qualified, or varied by virtue of any binding treaty (*Case Concerning Elettronica Sicula, S.p.A.*, United States of America v. Italy, 1989, I.C.J. Reports 4, para. 50). Such qualification took place here under NAFTA Articles 1121 and Annex 1120.1.

[The Tribunal then quoted Article 1121(2)(b) and (3) in relevant parts.]

73. It appears that this Article, rather than confirming or repeating the classical rule of exhaustion of local remedies, envisages a situation where domestic proceedings with respect to the same alleged breach referred to in Article 1117 are either available or even pending in a court or tribunal operating under the law of any Party. In such case, Article 1121(2)(b) requires, for a recourse to arbitration to be open, that the disputing investor waive his right to initiate or continue the other domestic proceedings. Therefore, in contrast to the local remedies rule, Article 1121(2)(b) gives preference to international arbitration rather than domestic judicial proceedings, provided that a waiver with regard to the latter is declared by the disputing investor.[b] This preference refers, however, to a claim for damages only, explicitly leaving available to a claimant "proceedings for injunctive, declaratory or other extraordinary relief" before the national courts. Thus, Article 1121(2)(b) and (3) substitutes itself as a qualified and special rule on the relationship between domestic and international judicial proceedings, and a departure from the general rule of customary international law on the exhaustion of local remedies. The thrust of such substitution seems to consist in making recourse to NAFTA arbitration easier and speedier, as opposed to the general pattern of opening up international arbitration to private parties as against third states. . . .

76. As far as the waiver requirement under Article 1121(2)(b) and (3) is concerned,

b. For an interesting case, in which an ICSID tribunal rejected jurisdiction over the dispute because of an inadequate waiver by the investor-claimant, see *Waste Management, Inc. v. United Mexican States*, ICSID Case Num. ARB(AF)/98/2 (June 2, 2000), *reprinted in*, 40 INT'L LEG. MAT. 56 (2001).

the Arbitral Tribunal is satisfied that the appropriate waivers were attached by both the Claimant and CEMSA . . . and also delivered to the Respondent, as indicated in the Notice of Arbitration . . . , noting that the Respondent has not challenged the delivery or the sufficiency of the waivers. . . .

77. Under Article 1121(2)(b), the waivers are required for, and limited to, claims for damages only. Indeed, the Notice of Arbitration presents as requests four related claims for damages (p. 11 under D); they do not apply to "proceedings for injunctive, declaratory or other extraordinary relief." A later request by the Claimant with regard to the illegality or invalidity of a tax assessment by the Respondent for about US$25 million asks for declaratory relief only and, therefore, does not require a waiver under Article 1121(2)(b) (see supra, paras. 72, 73). It has to be examined below, however, whether this request, while relieved from the requirement of waiver, stands properly before the Tribunal in terms of its scope of authority. . . .

H. Merits

H.1 Expropriation: Overview of the Positions of the Disputing Parties

89. In this proceeding, the Claimant's key contention is that the various actions of Mexican authorities, particularly SHCP, in denying the IEPS rebates on cigarette exports to CEMSA, resulted in an indirect or "creeping" expropriation of the Claimant's investment and were tantamount to expropriation under Article 1110. They were also arbitrary, confiscatory and discriminatory, a violation of the Claimant's right to due process. . . . The Claimant asserts that the "measures" he has complained about may also be characterized as a "denial of justice" (one aspect of denial of due process) under article 1110. . . . Nor does the Claimant believe that the Mexican government policy of limiting cigarette exports is justified by public policy concerns, particularly in light of the stated purpose of the IEPS law in 1980, which was to encourage Mexican exports. . . .

92. The Respondent disagrees on a variety of grounds. First, SHCP's actions–demanding invoices with the IEPS tax amounts stated separately as a condition of the IEPS rebates–were required by the IEPS law. That requirement in the Respondent's view is fully consistent with the 1993 Mexican Amparo Supreme Court case, which applied to both cigarette and alcoholic beverage exports, and decided only that resellers such as the Claimant, as well as producers, were entitled to the 0% IEPS tax rate on their exports. . . . SHCP was prepared to apply the 0% tax rate and to grant the rebates, but if and only if the Claimant complied with the other requirements of the IEPS law, including those relating to invoices. According to the Respondent, the question of the requirement that the person seeking the rebates be a taxpayer and, particularly, of invoices stating the tax amounts separately was never before the Mexican Supreme Court and was not decided by it. . . . Moreover, there was never any intent on the part of SHCP officials to waive the requirements of Article 4 of the IEPS law. Rebates are initially granted in a virtually automatic process, with SHCP reserving the right under the law to audit recipients to determine whether they were entitled to the rebates and whether the amounts sought were correct. . . .

H.2 Applicable Law: NAFTA Article 1110 and International Law

96. A threshold question is whether there is an "investment" that is covered by NAFTA. The term "investment" is defined in Article 1139, in exceedingly broad terms. It covers almost every type of financial interest, direct or indirect, except certain claims to money. The first listed item under "investment" is "an enterprise." There is no disagreement among the parties that Corporacion de Exportaciones Mexicanas, S.A. (CEMSA) is a corporate entity organized under the laws of Mexico, essentially wholly

owned by the American citizen investor, Marvin Roy Feldman Karpa . . . Among the dictionary definitions of "enterprise" are "a unit of economic organization or activity; esp. a business organization" (Webster's New Collegiate Dictionary, 1977 ed.). As such, the Tribunal determines that CEMSA comes within the term "enterprise" and is thus an "investment" under NAFTA. This conclusion is consistent with that reached by other NAFTA Chapter 11 tribunals. For example, the tribunal in *S.D. Myers v. Canada*[c] concluded that a Canadian corporation organized for the purpose of facilitating hazardous waste exports to the United States, an affiliate of S.D. Myers in the United States owned by the same shareholders as S.D. Myers, satisfied the NAFTA requirements for an "investment."[d]

97. Expropriation under Chapter 11 is governed by NAFTA Article 1110, although NAFTA lacks a precise definition of expropriation. . . . The key issue, in general and in the instant case, is whether the Respondent's actions constitute an expropriation.

98. The Article 1110 language is of such generality as to be difficult to apply in specific cases. In the Tribunal's view, the essential determination is whether the actions of the Mexican government constitute an expropriation or nationalization, or are valid governmental activity. . . . If there is a finding of expropriation, compensation is required, even if the taking is for a public purpose, non-discriminatory and in accordance with due process of law and Article 1105(1).

99. The view that the conditions (other than the requirement for compensation) are not of major importance in determining expropriation is confirmed by the Restatement of the Law of Foreign Relations of the United States, a source relied on by many American and Canadian lawyers that has been discussed in the memorials of both the Claimant and the Respondent in this proceeding. For example, according to the Restatement, the public purpose requirement "has not figured prominently in international claims practice, perhaps because the concept of public purpose is broad and not subject to effective reexamination by other states." (American Law Institute, Restatement of the Law Third, the Foreign Relations of the United States, USA, American Law Institute Publishers, Vol. 1, 1987, (hereinafter Restatement), Section 712, Comment g.). Similarly, the Restatement suggests that if proper compensation is paid for an expropriation, the fact that the taking was not for a public purpose and was discriminatory, "might not in fact be successfully challenged." A comment observes, perhaps somewhat inconsistently, that "economic injuries [falling under section 712(3)] are generally unlawful because they are discriminatory or are otherwise arbitrary." (*Id.*, Sec. 712, Comment i.) This last clause suggests that if the government actions (legislative, administrative or judicial) are discriminatory or arbitrary (or perhaps unfair or inequitable), as arguably is the case here, they are more likely to be viewed as expropriatory, imparting a degree of circularity to the "expropriation versus regulation" dichotomy.

100. Most significantly with regard to this case, Article 1110 deals not only with direct takings, but indirect expropriation and measures "tantamount to expropriation," which potentially encompass a variety of government regulatory activity that may significantly interfere with an investor's property rights. The Tribunal deems the scope of both expressions to be functionally equivalent. Recognizing direct expropriation is relatively easy: governmental authorities take over a mine or factory, depriving the

c. *S.D. Myers, Inc. v. Government of Canada*, NAFTA Arbitration (November 12, 2000), *reprinted in*, 40 INT'L LEG. MAT. 1408 (2001).

d. *Id.*, ¶¶ 230-231.

investor of all meaningful benefits of ownership and control. However, it is much less clear when governmental action that interferes with broadly-defined property rights–an "investment" under NAFTA, Article 1139–crosses the line from valid regulation to a compensable taking, and it is fair to say that no one has come up with a fully satisfactory means of drawing this line.

101. By their very nature, tax measures, even if they are designed to and have the effect of an expropriation, will be indirect, with an effect that may be tantamount to expropriation. If the measures are implemented over a period of time, they could also be characterized as "creeping," which the Tribunal also believes is not distinct in nature from, and is subsumed by, the terms "indirect" expropriation or "tantamount to expropriation" in Article 1110(1). The Claimant has alleged "creeping expropriation." The Respondent has objected that the Claimant has in effect added a new element to the case which, among other things, should have been submitted to the Competent Authorities under Article 2103(6) for a determination as to whether it should be excluded from consideration as an expropriation. The Restatement defines "creeping expropriation" in part as a state seeking "to achieve the same result [as an outright taking] by taxation and regulatory measures designed to make continued operation of a project uneconomical so that it is abandoned" (Restatement, Section 712, Reporter's Note 7). Since the Tribunal believes that creeping expropriation, as defined in the Restatement, noted above, is a form of indirect expropriation, and may accordingly constitute measures "tantamount to expropriation," the Tribunal includes consideration of creeping expropriation along with its consideration of these closely related terms.[7]

102. Ultimately, decisions as to when regulatory action becomes compensable under article 1110 and similar provisions in other agreements appear to be made based on the facts of specific cases. This Tribunal must necessarily take the same approach.

103. The Tribunal notes that the ways in which governmental authorities may force a company out of business, or significantly reduce the economic benefits of its business, are many. In the past, confiscatory taxation, denial of access to infrastructure or necessary raw materials, imposition of unreasonable regulatory regimes, among others, have been considered to be expropriatory actions. At the same time, governments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like. Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this. . . .

104. Drawing the line between expropriation and regulation has proved difficult both in the pre-NAFTA context and for the handful of NAFTA Chapter 11 tribunals that have considered the issue. Here again, despite the less specific language and the lack of references to "tantamount to expropriation," the Restatement is somewhat helpful, particularly the comments, in understanding customary international law in this area. Section 712 reads in pertinent part as follows:

> "A state is responsible under international law for injury resulting from:

7. The Tribunal notes that the *S.D. Myers* tribunal (citing *Pope & Talbot*) effectively concluded that the words "tantamount to expropriation" were designed to embrace the concept of "creeping" expropriation rather than to "expand the internationally accepted scope of the term expropriation." *See S.D. Myers v. Government of Canada*, Partial Award, November 13, 2000, para. 286, http://www.state.gov/documents/organization/3992.pdf.

(1) a taking by the state of the property of a national of another state that
(a) is not for a public purpose, or
(b) is discriminatory, or
(c) is not accompanied by provision for just compensation."

While the language itself differs considerably from Article 1110, many of the essential substantive elements are the same, particularly the concept of a taking and the conditions. . . .

107. Along with the Restatement, this Tribunal has also sought guidance in the decisions of several earlier NAFTA Chapter 11 Tribunals that have interpreted Article 1110. The Tribunal realizes that under NAFTA Article 1136(1), "An award made by a Tribunal shall have no binding force except between the disputing parties and in respect of the particular case," and that each determination under Article 1110 is necessarily fact-specific. However, in view of the fact that both of the parties in this proceeding have extensively cited and relied upon some of the earlier decisions, the Tribunal believes it appropriate to discuss briefly relevant aspects of earlier decisions, particularly *Azinian v. United Mexican States*[a] and *Metalclad v. United Mexican States*.[b] Nevertheless, there has been only one prior finding of a taking under Article 1110, in *Metalclad*, and the principal rationale for that decision was substantially overruled by the reviewing court, the Supreme Court of British Columbia. In the other decisions to date which have considered allegations of a violation of Article 1110 and attempted to articulate criteria for the determination (*S.D. Myers v. Canada* and *Pope & Talbot v. Canada*) the tribunals for various reasons have failed to find violations of Article 1110.

H.3 Respondent's Actions as an Expropriation Under Article 1110.

108. The Tribunal has struggled at considerable length, in light of the facts and legal arguments presented, the language of Article 1110 and other relevant NAFTA provisions, principles of customary international law and prior NAFTA tribunal decisions, to determine whether the actions of the Respondent relating to the Claimant constituted indirect or "creeping" expropriation, or actions tantamount to expropriation. (There is in this case no allegation of a direct expropriation or taking under Article 1110.) The conclusion that they do not is explained below.

109. The facts presented here might, depending on their interpretation, appear to support a finding of an indirect or creeping expropriation. The Claimant, through the Respondent's actions, is no longer able to engage in his business of purchasing Mexican cigarettes and exporting them, and has thus been deprived completely and permanently of any potential economic benefits from that particular activity.[8] . . .

110. No one can seriously question that in some circumstances government regulatory activity can be a violation of Article 1110. For example, in *Pope & Talbot*, Canada argued that "mere interference is not expropriation; rather, a significant degree of deprivation of fundamental rights of ownership is required."[10] That tribunal rejected this

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a. *Azinian v. United Mexican States*, ICSID CASE No. ARB(AF)/97/2 (November 1, 1999), *reprinted in*, 39 INT'L LEG. MAT. 537 (2000).

b. *Supra* at [redacted].

8. [T]here is a serious question as to whether the Claimant's business would have been economically viable even had SHCP consistently granted the rebates in the proper amount, given the very low gross profit, based on the gross profit of less than US$0.10 between CEMSA's net-of-tax cost of the cigarettes and the selling prices realized from CEMSA's customers.

10. *Pope & Talbot v. Government of Canada*, Interim Award, June 26, 2000, paras. 87-88, http://www.state.gov/documents/ organization/3989.pdf. Canada also asserted that "tantamount" simply means "equivalent," and that this language was not intended to expand Article 1110's coverage beyond creeping expropriation to cover regulatory action. *Id*. para. 89.

approach:

> Regulations can indeed be characterized in a way that would constitute creeping expropriation ... Indeed, much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protection against expropriation. (*Id*., para. 99.)

However, the *Pope & Talbot* tribunal failed to find a violation of Article 1110 in that case. This Tribunal finds the legal arguments against a finding of expropriation more persuasive, for reasons described in detail below, and reaches the same conclusion on facts very different from those in *Pope & Talbot*.

111. This Tribunal's rationale for declining to find a violation of Article 1110 can be summarized as follows: (1) As *Azinian* suggests, not every business problem experienced by a foreign investor is an expropriation under Article 1110; (2) NAFTA and principles of customary international law do not require a state to permit "gray market" exports of cigarettes; (3) at no relevant time has the IEPS law, as written, afforded Mexican cigarette resellers such as CEMSA a "right" to export cigarettes (due primarily to technical/legal requirements for invoices stating tax amounts separately and to their status as non-taxpayers); and (4) the Claimant's "investment," the exporting business known as CEMSA, as far as this Tribunal can determine, remains under the complete control of the Claimant, in business with the apparent right to engage in the exportation of alcoholic beverages, photographic supplies, contact lenses, powdered milk and other Mexican products–any product that it can purchase upon receipt of invoices stating the tax amounts–and to receive rebates of any applicable taxes under the IEPS law. While none of these factors alone is necessarily conclusive, in the Tribunal's view taken together they tip the expropriation/regulation balance away from a finding of expropriation. . . .

H.3.5 Non-Discrimination

137. The Chapter 11 scheme establishes a right to national treatment for investors (and damages for breach thereof) that is distinct from the right to damages from acts of expropriation.[26] In this respect, the Tribunal notes that the *S.D. Myers* tribunal, having weighed the allegations of expropriation and finding no violation of Article 1110, nevertheless found Canada in violation of its obligations under Article 1102 and Article 1105 (*S.D. Myers v. Government of Canada*, Partial Award, November 13, 2000, paras. 256, 268, http://www.state.gov/documents/organization/3992.pdf), violations that also constituted discrimination under Article 1110(1)(b) and denial of fair and equitable treatment under Article 1110(1)(c). . . .

H.3.6 Due Process/Fair and Equitable Treatment/Denial of Justice

138. Regarding the possible claim of a denial of due process or a denial of justice, the

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26. Moreover, under international law, there is considerable doubt whether the discrimination provision of Article 1110 covers discrimination other than that between nationals and foreign investors, *i.e*., it is not applicable to discrimination among different classes of investors, such as between producers and resellers of tobacco products, at least unless all producers are nationals and all resellers are aliens. Thus, under the Restatement, the relevant comment states that "a program of taking that singles out aliens generally, or aliens of a particular nationality, or particular aliens, would violate international law." The comment does not refer to discrimination between national producers and resellers (whether national or foreign) operating under somewhat different circumstances, particularly under the tax laws. Also, there is an implication in the NAFTA Parties' interpretation of Article 1105 of July 31, 2001, that a breach of one substantive provision of Section A should not in itself be considered a breach of a separate provision (NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions, July 31, 2001, consulted on the web site of the Department of Foreign Affairs and International Trade of the Government of Canada. *See* NAFTA Articles 1131(2) and 2001).

Tribunal notes that the Claimant actually alleges a denial of justice primarily with regard to SHCP's failure–the failure of the Executive Branch–to implement the 1993 Amparo decision. . . . The Claimant only suggests in passing that the nullification decision of the circuit court may rely on a provision of the 1998 IEPS law to deny rebates that the Claimant sought for 1997. . . . In April 1998, the Claimant was effectively forced to seek "injunctive, declaratory or other extraordinary relief" before the Mexican Fiscal Court, as permitted under Article 1121. In that first case, CEMSA sought a declaratory judgment confirming CEMSA's right to receive tax rebates. This was necessary because of a determination of the tax authorities that CEMSA was not entitled to the rebates for exports made in October-November 1997, since CEMSA could not present invoices that complied with the Article 4 requirement that the IEPS tax amounts be stated separately, and was not a taxpayer entitled to claim IEPS rebates under Article 11 (the latter applied only to the situation under the amended IEPS law effective January 1, 1998). In that action the Mexican courts ultimately decided, inter alia, that CEMSA was subject to the invoice requirements of Article 4 (proceeding related to the negative response to a request presented to the tax authority referred above in paragraph 84). The Tribunal notes that this decision is in obvious conflict with the Claimant's interpretation of the 1993 Amparo decision as guaranteeing the Claimant's right to obtain IEPS rebates notwithstanding the Article 4 invoice requirement. In a separate action challenging SHCP's decision to audit CEMSA and ultimately to demand return of the rebate amounts paid to CEMSA between April 1996 and September 1997 . . . , the issue of whether the invoice requirements under Article 4 of the IEPS law are legal under Mexican law and the Mexican constitution remains pending.

139. Assuming that Article 1110 must be interpreted in accordance with international law, as Article 1131(1) states, not just any denial of due process or of fair and equitable treatment (the latter through the cross-reference in Article 1110(1)(c) to Article 1105) constitutes a violation of international law. In this instance, the allegations of denial of due process or denial of justice are weakened by several factors. Here, as in *Azinian*, the Claimant does not effectively contend that there was a denial of justice by Mexican courts, either with regard to the Supreme Court's Amparo decision or the various lower courts' subsequent determinations in the nullification and assessment cases. Rather, in the instant case the Claimant's assertions of denial of justice relate to actions of SHCP rather than the courts. . . . *Azinian* states that "A governmental authority surely cannot be faulted for acting in a manner validated by its own courts unless the courts themselves are disavowed at the international level." *Azinian* further suggests that there must be a showing that the court decision itself is a violation of NAFTA, or that the relevant courts have not accepted the suit, or there is "a clear and malicious misapplication of the law" (*Robert Azinian and Others v. The United Mexican States*, Award, November 1, 1999, paras. 97, 102, 103, 14 ICSID Review. FILJ 2, 1999).

140. This is a standard that the nullity and assessment decisions almost certainly do not meet.[27] Given . . . that Mexican courts and administrative procedures at all relevant times have been open to the Claimant, the Claimant's victory in the 1993 Amparo decision, and the availability of court review in the nullity and assessment decisions filed by the Claimant in 1998, there appears to have been no denial of due process or denial of justice there as would rise to the level of a violation of international law. ...

27. Moreover, the Mexican courts have been deciding issues of national law which it is inappropriate for the Tribunal to review, except and unless those determinations (or of Mexican administrative agencies such as SHCP) are themselves denials of justice or otherwise in violation of NAFTA or international law.

141. While there may be an argument for a violation of Article 1105 under the facts of this case (a denial of fair and equitable treatment), this Tribunal has no jurisdiction to decide that issue directly. . . . Article 1105 is not available in tax cases, but may be relevant in the cross-reference of Article 1110(1)(c). The Tribunal does not need to decide whether this cross-reference makes a full Article 1105 consideration appropriate in a tax matter. Even assuming, *arguendo*, that the Respondents' actions in the aggregate do constitute a denial of fair and equitable treatment that reaches the relatively egregious level of a violation of international law, this alone does not establish the existence of an illegal expropriation under Article 1110. As *S.D. Myers* indicates, it may be appropriate for a NAFTA tribunal to find a violation of Article 1105 and at the same time decline to find a violation of Article 1110(1)(c).

H.3.7 The Claimant in Control of CEMSA

142. Although the Tribunal does not consider this a controlling argument, the regulatory action has not deprived the Claimant of control of his company, CEMSA, interfered directly in the internal operations of CEMSA or displaced the Claimant as the controlling shareholder. The Claimant is free to pursue other continuing lines of business activity, such as exporting alcoholic beverages or photographic supplies, as in the past, or other products for which he can obtain from Mexico the invoices required under Article 4. Of course, he was effectively precluded from exporting cigarettes, certainly by the IEPS law amendments, that went into force in 1998 making the IEPS rebates available only to producers, and in the Tribunal's view by the invoice requirements of Article 4(III), which were stated requirements of Mexican law at least since 1987, and did not change at any relevant time subsequently. However, this does not amount to Claimant's deprivation of control of his company. . . .

153. On the factual basis set out in the record, and this analysis, the Tribunal holds that the actions of Mexico with regard to the Claimant's investment do not constitute an expropriation under Article 1110 of NAFTA.

I. National Treatment (NAFTA Article 1102)

154. In the present case, there are only a handful of relevant investors, one foreign (the Claimant) and one domestic (the Poblano-Guemes Group), each engaged in the business of purchasing Mexican cigarettes and marketing those cigarettes abroad. These investors cannot purchase the cigarettes from Mexican cigarette producers because the producers (and their wholly owned distributors) refuse to sell to them. Therefore, the Claimant or the Poblano Group firms must purchase their cigarettes from volume retailers, Walmart and Sam's Club. Since Walmart and Sam's Club are retailers and not IEPS taxpayers, they do not have available to them the precise amounts of the IEPS taxes included in the price paid first by the retailers in the transaction with the producers or distributors, and then by the Claimant and other reseller/exporters. Accordingly, neither the Claimant nor the Poblano Group companies can comply with the requirement of the IEPS law, Article 4(III), which makes it a condition of obtaining tax rebates upon export that the applicant be a taxpayer who possesses invoices showing the tax amount stated separately. . . .

I.2 Analysis by the Tribunal

165. The national treatment/non-discrimination provision is a fundamental obligation of Chapter 11.[35] The concept is not new with NAFTA. Analogous language in Article

35. *See* Daniel M. Price & P. Brian Christy, *An Overview of the NAFTA Investment Chapter*, in THE NORTH AMERICAN FREE TRADE AGREEMENT: A NEW FRONTIER IN INTERNATIONAL TRADE AND INVESTMENT IN THE AMERICAS 165, 174 (Judith H. Bello, Allan F. Holmer & Joseph J. Norton, eds., 1994).

III of the GATT has applied as between Canada and the United States since 1947, and with Mexico since 1985, with regard to trade in goods. Article 1602 of the United States-Canada Free Trade Agreement, with regard to investment, applied between those two NAFTA Parties from 1989-1993. . . .

166. Despite its deceptively simple language, the interpretative hurdles for Article 1102 are several. They include (a) which domestic investors, if any, are in "like circumstances" with the foreign investor; (b) whether there has been discrimination against foreign investors, either de jure or de facto; (c) the extent to which differential treatment must be demonstrated to be a result of the foreign investor's nationality; and (d) whether a foreign investor must receive the most favorable treatment given to any domestic investor or to just some of them.[36]

167. Analysis of these issues in the present case is complicated by the fact that only a limited amount of relevant factual information has been presented to the Tribunal, particularly with regard to the various domestic companies which may be in the business of reselling and exporting cigarettes from Mexico, and the treatment by SHCP of those resellers other than the Claimant. Neither party suggests that there are any foreign owned reseller/exporters other than the Claimant. One of the Respondent's witnesses indicated under questioning that there might be 5-10 or more other firms registered in Mexico for exporting cigarettes. There is agreement between the parties that there is at least one Mexican owned reseller/exporter, the so-called "Poblano Group," consisting of Mercados Regionales and Mercados Extranjeros ("Mercados I" and "Mercados II") and possibly other entities. A third company, MEXCOBASA, was mentioned by the Claimant but the ownership is not indicated in the record (first Feldman statement, para. 94). A Mexican official, Enrique Diaz Guzman, has confirmed that at least three trading companies (i.e., not producers) received IEPS rebates for cigarette exports at various times between September 1996 and May 2000, in the total amount of approximately NP$ 91,000,000. . . . Many of those rebates were authorized and paid after January 1, 1998, when amendments to the IEPS law effectively made the 0% tax rate and IEPS rebates on cigarette exports legally unavailable to anyone other than producers (by limiting the payment of the tax rebates to the first sale) (1998 IEPS law, Article 11).

168. There is disagreement as to how these trading companies (presumably the Poblano Group companies) were treated in comparison to the Claimant, that is, whether the Poblano Group was provided IEPS tax rebates denied during some periods to the Claimant, notwithstanding the same lack of invoices stating the tax amounts separately, as required by Article 4 and, after January 1, 1998, notwithstanding the bar to rebates except on the first sale. There is also a lack of detailed information as to whether SHCP has made effective efforts to recoup the rebates provided to the Poblano Group for the 1996-1997 period, as it has with respect to the Claimant, or for IEPS payments made in 1998 to 2000. On the grounds that there is an ongoing audit of Caesar Poblano, the principal owner of the Poblano Group companies, SHCP has declined to provide any detailed information on the treatment of the Poblano Group and how that treatment compares to treatment by SHCP of the Claimant. One of SHCP's witnesses, Mr. Diaz Guzman, did, however, state that only one of the three trading companies he identified

36. The issue of whether the size of the "universe" of foreign investors, and of domestic investors, matters has been an issue in other NAFTA Chapter 11 cases, including *S.D. Myers* (*see S.D. Myers v. Government of Canada*, Partial Award, November 13, 2000, paras. 93, 112, 256, >) and particularly in *Pope & Talbot* (*see Pope & Talbot v. Government of Canada*, Interim Award, June 26, 2000, paras. 11, 24, 36, 38, http://www.state.gov/documents/organization/3989.pdf). However, the Respondent here has not raised that issue, and the Tribunal accordingly does not address it. . . .

was in the process of audit (as of March 2001), so presumably there are two others which have not been audited, despite being in like circumstances with the Claimant.

169. Also, given that this is a case of likely *de facto* discrimination, it does not matter for purposes of Article 1102 whether in fact Mexican law authorizes SHCP to provide IEPS rebates to persons who are not formally IEPS taxpayers and do not have invoices setting out the tax amounts separately, as has been required by the IEPS law consistently since at least 1987 and perhaps earlier. The question, rather, is whether rebates have in fact been provided for domestically owned cigarette exporters while denied to a foreign re-seller, CEMSA. Mexico is of course entitled to strictly enforce its laws, but it must do so in a non-discriminatory manner, as between foreign investors and domestic investors. Thus, if the IEPS Article 4 invoice requirement is ignored or waived for domestic cigarette reseller/exporters, but not for foreign owned cigarette reseller/exporters, that de facto difference in treatment is sufficient to establish a denial of national treatment under Article 1102.

I.2.1 In Like Circumstances

170. In the investment context, the concept of discrimination has been defined to imply unreasonable distinctions between foreign and domestic investors in like circumstances (Restatement, Sec. 712, Comment f). . . . [T]here are at least some rational bases for treating producers and resellers differently, *e.g*., better control over tax revenues, discourage smuggling, protect intellectual property rights, and prohibit gray market sales, even if some of these may be anti-competitive.[37] Thus, . . . the Tribunal does not believe that such producer-reseller discrimination is a violation of international law.

171. In this instance, the disputing parties agree that CEMSA is in "like circumstances" with Mexican owned resellers of cigarettes for export, including the two members of the Poblano Group, Mercados Regionales and Mercados Extranjeros . . . , although Mexico of course denies that there has been any discrimination largely on the ground that CEMSA and the Poblano Group are effectively the same entity. In the Tribunal's view, the "universe" of firms in like circumstances are those foreign-owned and domestic-owned firms that are in the business of reselling/exporting cigarettes. Other Mexican firms that may also export cigarettes, such as Mexican cigarette producers, are not in like circumstances. While the Claimant's Amparo decision held discrimination between producers and resellers of alcohol and tobacco products (at least as to the availability of the 0% tax rate for exported goods) to be unconstitutional, such discrimination is effectively reinstated by the 1998 IEPS law that limits IEPS tax rebates to the first sale, excluding any subsequent purchaser/exporter from the benefit, and has effectively been upheld in the other litigation brought by the Claimant in 1998, also discussed earlier. The Tribunal also notes that Article 1102 says nothing regarding discrimination among different classes of a Party's own investors.

172. Accordingly, the Tribunal holds that the companies which are in like circumstances, domestic and foreign, are the trading companies, those in the business of purchasing Mexican cigarettes for export, which for purposes of this case are CEMSA and the corporate members of the Poblano Group.

I.2.2 Existence of Discrimination

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37. With minor exceptions, NAFTA does not regulate the creation and maintenance of monopolies. "Nothing in this Agreement shall be construed to prevent a Party from designating a monopoly." Article 1502(1). Thus, affording cigarette producers a monopoly on exports would not appear to be an article 1102 violation, as long as all non-producers, both domestic and foreign, are treated in the same manner.

173. The limited facts made available to the Tribunal demonstrate on balance to a majority of the Tribunal that CEMSA has been treated in a less favorable manner than domestically owned reseller/exporters of cigarettes, a de facto discrimination by SHCP, which is inconsistent with Mexico's obligations under Article 1102. The only confirmed cigarette exporters on the limited record before the tribunal are CEMSA, owned by U.S. citizen Marvin Roy Feldman Karpa, and the Mexican corporate members of the Poblano Group, Mercados I and Mercados II. According to the available evidence, CEMSA was denied the rebates for October-November 1997 and subsequently; SHCP also demanded that CEMSA repay rebate amounts initially allowed from June 1996 through September 1997. Thus, CEMSA was denied IEPS rebates during periods when members of the Poblano Group were receiving them. . . .

I.2.3 Discrimination as a Result of Nationality

181. It is clear that the concept of national treatment as embodied in NAFTA and similar agreements is designed to prevent discrimination on the basis of nationality, or "by reason of nationality." . . . However, it is not self-evident, as the Respondent argues, that any departure from national treatment must be explicitly shown to be a result of the investor's nationality. There is no such language in Article 1102. Rather, Article 1102 by its terms suggests that it is sufficient to show less favorable treatment for the foreign investor than for domestic investors in like circumstances. In this instance, the evidence on the record demonstrates that there is only one U.S. citizen/investor, the Claimant, that alleges a violation of national treatment under NAFTA Article 1102 . . . , and at least one domestic investor (Mr. Poblano) who has been treated more favorably. For practical as well as legal reasons, the Tribunal is prepared to assume that the differential treatment is a result of the Claimant's nationality, at least in the absence of any evidence to the contrary.

182. However, in this case there is evidence of a nexus between the discrimination and the Claimant's status as a foreign investor. In the first place, there does not appear to be any rational justification in the record for SHCP's less favorable de facto treatment of CEMSA other than the obvious fact that CEMSA was owned by a very outspoken foreigner, who had, prior to the initiation of the audit, filed a NAFTA Chapter 11 claim against the Government of Mexico. Certainly, the action of filing a request for arbitration under Chapter 11 could only have been taken by a person who was a citizen of the United States or Canada (rather than Mexico), *i.e.*, as a result of his (foreign) nationality. While a tax audit in itself is not, of course, evidence of a denial of national treatment, the fact that the audit was initiated shortly after the Notice of Arbitration . . . and the existence of the unsigned memo at SHCP noting the filing of the Chapter 11 claim in the context of the Claimant's export registration efforts, at minimum raise a very strong suspicion that the events were related, given that no similar audit action was taken against domestic reseller/exporter taxpayers at the time.

183. More generally, requiring a foreign investor to prove that discrimination is based on his nationality could be an insurmountable burden to the Claimant, as that information may only be available to the government. It would be virtually impossible for any claimant to meet the burden of demonstrating that a government's motivation for discrimination is nationality rather than some other reason. Also, as the Respondent argues, if the motives for a government's actions should not be examined, there is effectively no way for the Claimant or this Tribunal to make the subjective determination that the discriminatory action of the government is a result of the Claimant's nationality, again in the absence of credible evidence from the Respondent of a different motivation. If Article 1102 violations are limited to those where there is explicit

(presumably de jure) discrimination against foreigners, *e.g.*, through a law that treats foreign investors and domestic investors differently, it would greatly limit the effectiveness of the national treatment concept in protecting foreign investors. . . .

I.2.4 Most Favored Investor Requirement?

185. NAFTA is on its face unclear as to whether the foreign investor must be treated in the most favorable manner provided for any domestic investor, or only with regard to the treatment generally accorded to domestic investors, or even the least favorably treated domestic investor. There is no "most-favored investor" provision in Chapter 11, parallel to the most favored nation provision in Article 1103, that suggests that a foreign investor must be treated no less favorably than the most favorably treated national investor, if there are other national investors that are treated less favorably, that is, in the same manner as the foreign investor. At the same time, there is no language in Article 1102 that states that the foreign investor must receive treatment equal to that provided to the most favorably treated domestic investor, if there are multiple domestic investors receiving differing treatment by the respondent government.

186. It may well be that the size of the domestic investor class here is larger than two–one Mexican government witness stated that there might be 5-10 or more registered to export cigarettes–and it may also be that some of those other investors have been treated in a manner more similar to the Claimant's treatment than to the more favorable treatment afforded to the Poblano Group. However, in the absence of evidence to this effect presented by Mexico–the only party in a position to provide such information–the Tribunal need not decide whether Article 1102 requires treatment equivalent to the best treatment provided to any domestic investors. Presumably, if there was evidence that another domestic investor had been treated in a manner equivalent to the Claimant, in terms of export registration, audit, and granting or withholding of rebates, the Respondent would have provided that evidence to the Tribunal. In this case, the known "universe" of investors is only two, or at the most three, one foreign (the Claimant) and one domestic (the Poblano Group companies), and the Tribunal must make its decision on the evidence before it. Thus, the only relevant domestic investor is the Poblano Group and the comparison must be between the Poblano Group and Claimant.

187. On the basis of this analysis, a majority of the Tribunal concludes that Mexico has violated the Claimant's rights to non-discrimination under Article 1102 of NAFTA. The Claimant has made a prima facie case for differential and less favorable treatment of the Claimant, compared with treatment by SHCP of the Poblano Group. . . .

NOTES AND QUESTIONS

1. Recall ¶ 5, *supra*. Not all NAFTA investment disputes are resolved under ICSID practice. For example, *S.D. Myers*, discussed in *Feldman* (*see, e.g.*, ¶¶ 96, 101, *supra*) was a NAFTA arbitration instituted under the UNCITRAL Arbitration Rules, pursuant to NAFTA Article 1120.

2. Article 26 of the ICSID Convention, *supra*, allows for a state to require exhaustion of local remedies. Yet NAFTA Article 1121(2)-(3) appears to restrict this doctrine. *Feldman*, ¶¶ 71, 73, *supra*. Is *Feldman* consistent with the ICSID Convention? On its own merits, what do think of the tribunal's analysis of the exhaustion of local remedies issue?

3. Compare the *Feldman* tribunal analysis of the expropriation claim (¶¶ 96-111, *supra*) with that of *MTD* (¶ 214, *supra*) and *Metalclad* (¶¶ 102-112) in Chapter 19, *supra* at [redacted]-[redacted]. These involve claims of indirect expropriation ("creeping expropriation")

resulting from administrative or regulatory action. Why is the claimant successful in *Metalclad* and unsuccessful in the other two decisions?

4. Consider ¶¶ 138-141, *supra*. Are the Claimants' due process arguments simply another legal approach to the "creeping expropriation" arguments that the tribunal had already rejected? What do you think of the tribunal's analysis of the due process arguments on their own merits?

5. Are you satisfied with the tribunal majority's analysis of the national treatment issue (¶¶ 154, 165-183, *supra*)? With "only a limited amount of relevant factual information" before the tribunal, are its conclusions justified? Does its analysis essentially place a burden on the respondent state to overcome a rebuttable presumption of discrimination once a bare prima facie showing is made by a claimant? If so, is this burden fair?

6. The tribunal insists that there is no "most-favored-investor" principle under NAFTA Chapter Eleven (¶ 185, *supra*). Then what is the basis for comparison of treatment under NAFTA Article 1102?

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