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## **Last investment arbitration awards of 2004\***

During the last quarter of 2004 three investment arbitration Tribunals dealt with jurisdiction and merit issues of relevance to investors and States. The present report highlights some of the points addressed therein.

**In PSEG Global, Inc., The North American Coal Corporation, and Konya Ingin Elektrik Uretim v. Ticaret Limnited Sirketi v. Republic of Turkey<sup>1</sup>** the ICSID Tribunal reached a decision on jurisdiction whereby it held it had jurisdiction over the dispute submitted by American company PSEG Global, Inc and its Turkish subsidiary Konya Ingin but held it did not have jurisdiction over the dispute submitted by The North American Coal Corporation.

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<sup>1</sup> PSEG Global, Inc., The North American Coal Corporation, and Konya Ingin Elektrik Uretim ve Ticaret Limnited Sirketi Vs. Republic of Turkey, award of June 4, 2004, <http://www.asil.org/ilib/psegdecision.pdf>

The dispute related a contract to develop a power plant in the Turkish Province of Konya. The Claimants contended that Turkey, having authorized the investment and having concluded a valid and binding Concession Contract, harmed their investment by depriving them of the Treasury guarantee, the long-term power purchase agreement and the Fund Agreement. Claimants alleged violation of the BIT between the United States of America and Turkey.

## **Concession contract as investment**

Turkey objected to the jurisdiction of the Tribunal based on four arguments, one of which was related to the argument that there was not an investment. The Tribunal concluded that an investment was made in the form of a Concession Contract and rejected Respondent's argument according to which the Contract was signed as a mere courtesy or sign of good will. "Letters of intention or other instruments would have sufficed to provide a general framework to continue negotiations until an agreement was reached or not without any legal consequences for either party, as the events in *Mihaly* show".<sup>2</sup>

## **Notification under Article 25(4) of the ICSID Convention**

Turkey also objected the Tribunal's jurisdiction because it had notified ICSID as per the terms of 25(4) of the ICSID Convention that "only the disputes arising directly out of investment activities which have obtained necessary permission, in conformity with the relevant legislation of the Republic of Turkey on foreign capital, and that have effectively started

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<sup>2</sup> *Id* at para 103.

shall be subject to the jurisdiction of the Centre”. Article 25(4) of the ICSID Convention, states: “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).”

The Tribunal stressed the differences between that notification and the arbitral consent. It stated that “Article 25(4) in itself does not assign any particular legal effect to notifications as it refers to the disputes that the Contracting State ‘would or would not consider submitting to the jurisdiction of the Centre’”.<sup>3</sup> The tribunal pointed out that those notifications were useful “for information purposes” about the types of disputes a State would consider consent to be submitted to ICSID. The Tribunal categorized these notifications as declarations and stressed that “These declarations do not alter the legal rights and obligations under the treaty nor do they amend any of its provisions. They are simply an instrument that allows States to express questions of policy to which they are not bound and that do not create rights for other parties”.<sup>4</sup> It then noted that some countries, like China, reproduce the terms of those notifications in BITs and therefore make the disputes exclusion legally effective.

#### **When the dispute is contract and treaty-based**

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<sup>3</sup> *Id* at para 136.

<sup>4</sup> *Id* at para 144.

Turkey objected to jurisdiction on the basis of the Claimants not having resorted to previously agreed dispute settlement procedures. The Tribunal rejected the argument and citing previous ICSID cases it pointed out that if the dispute was contract-based, the dispute settlement procedure choice established in the contract would apply but if the dispute was treaty-based a contractual dispute settlement procedure provision would not impede application of the treaty standard. However, if the dispute was both contract and treaty-based because it related to the issue of interpretation and implementation of the Contract as an investment agreement and to the allegation that the Government, through various measures, impeded and ultimately destroyed the investment, then the dispute would qualify as treaty-based.<sup>5</sup>

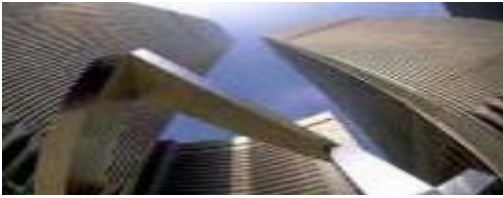
#### **Jurisdiction when minority shareholders are already protected**

Turkey objected to the jurisdiction of the Tribunal because The North American Coal Corporation was not a signatory to the contract and had an option to acquire only 25% of equity interest in the investment and therefore lacked standing. The Tribunal found that the definition of investment under the relevant BIT did not include an equity option, and that therefore, The North American Coal Corporation interest could not constitute an investment for purposes of ICSID jurisdiction. It also added that only PSEG could be considered legally linked to the Turkish Government for purposes of the Contract and operation of the Treaty, including the consent given to arbitration. Other equity holders do not have an interest

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<sup>5</sup> *Id* at para 173.

separate from these entities and consequently cannot claim on their own. It then stated:



“The case may be different when minority shareholders are accorded a right to claim independently from the project company because, for example, of question of nationality or other reason as in *CMS or Enron*. In those cases the interest of the investor would be nugatory if they were allowed to claim in their own right. The operation of the respective treaties would then be paralyzed”.<sup>6</sup>

In **Waste Management Inc. v. United Mexican States**,<sup>7</sup> an American company brought a claim against Mexico for second time<sup>8</sup> under Chapter Eleven of NAFTA. It was submitted to ICSID’s additional facility. The dispute arose out a concession contract between Waste Management’s Mexican subsidiary, Acaverde, and the City of Acapulco, under which Claimant was granted the exclusive right to dispose of the municipal waste generated in a certain district of Acapulco and to provide street cleaning services. The city was to enforce the ordinances that prohibited

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<sup>6</sup> *Id* at para 192.

<sup>7</sup> *Waste Management Inc. v. United Mexican States*, award of April 30, 2004, [http://www.economia-snci.gob.mx/sphp\\_pages/importa/sol\\_controlo/con\\_sultoria/Casos\\_Mexico/Waste\\_2\\_management/laudo/laudo\\_ingles.pdf](http://www.economia-snci.gob.mx/sphp_pages/importa/sol_controlo/con_sultoria/Casos_Mexico/Waste_2_management/laudo/laudo_ingles.pdf)

<sup>8</sup> The first ICSID Tribunal dismissed Waste Management’s claim because it had failed to waive those domestic proceedings in Mexico.

others from providing competing services in that district. The parties clashed over certain terms during the implementation of the contract and a dispute arose. Waste management filed an arbitration claim alleging violation of treatment and expropriation provisions of NAFTA Chapter Eleven because it was subject to arbitrary acts by Respondent which were “capricious, lacking in due process of law and which rendered the investment valueless.”<sup>9</sup>

### **When denial of justice is a violation of standard of treatment**

Claimant alleged that Respondent had violated Article 1105 of NAFTA by incurring in denial of justice because the City of Acapulco adopted a litigation strategy that slowed the process of recovery under local laws. The Tribunal pointed out that “...a litigant cannot commit a denial of justice unless its improper strategies are endorsed and acted on by the court, or unless the law gives it some extraordinary privilege which leads to a lack of due process”.<sup>10</sup> It also stressed that the “...the basic obligation of the State under Article 1105(1) is to act in good faith and form, and not deliberately to set out to destroy or frustrate the investment by improper means”.<sup>11</sup>

### **Non-performance of contract is not expropriation**

Regarding the issue of expropriation, the Tribunal stated that “... an enterprise is not expropriated just because its debts are not paid or other contractual obligations towards it are breached...It

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<sup>9</sup> *Supra* note 7 at para 87.

<sup>10</sup> *Id* at para 131.

<sup>11</sup> *Id* at para 138.

is not the function of Article 1110 to compensate for failed business ventures, absent arbitrary intervention by the State amounting to a virtual taking or sterilising of the enterprise”.<sup>12</sup>

It then pointed out that “...non-performance of a contractual obligation is not to be equated with a taking of property, nor (unless accompanied by other elements) is it tantamount to expropriation”.<sup>13</sup>

The Tribunal concluded that “...it is one thing to expropriate a right under a contract and another to fail to comply with the contract.”<sup>14</sup> It then added that “...it is not the function of the international law of expropriation as reflected in Article 1110 to eliminate the normal commercial risks of a foreign investor...a failing enterprise is not expropriated just because debts are not paid or other contractual obligations are not fulfilled.”<sup>15</sup>

The Tribunal dismissed the claim and held that it had not found any breach of Article 1105 or 1110 of NAFTA.

In **Gami Investments, Inc v. The Government of the United Mexican States**,<sup>16</sup> an investment arbitration claim was brought to a Tribunal under UNCITRAL rules of arbitration by an American company under Chapter Eleven of NAFTA.

The dispute stemmed from American company, GAMI’s ownership at GAM, Mexico’s fourth largest sugar producer as of 2001, of 14.18% equity. Five of GAM’s mills were expropriated by decree in September of 2001 by the government. GAM, sued and succeeded in local courts for the loss of three of those mills – with a claim still pending related to two others. GAMI, pursued its own international claim for alleged violation of NAFTA’s provisions on national treatment, minimum standards of treatment, and expropriation.

GAMI argued that the value of its shareholding was adversely affected by governmental measures imposed on GAM’s business.

#### **Violation of treatment standards for “maladministration”**

The Tribunal dismissed the argument that “maladministration” of the Mexican sugar industry led to a violation of NAFTA Article 1105 (international minimum standards and fair and equitable treatment). It held that “The duty of NAFTA tribunals is rather to appraise whether and how preexisting laws and regulations are applied to the foreign investor. It is no excuse that regulation is costly. Nor does a dearth of able administrators or a deficient culture of compliance provide a defence. Such is the challenge of governance that confronts every country. Breaches of NAFTA are assuredly not to be excused on the grounds that a government’s compliance with its own law may be difficult. Each NAFTA party must to the contrary accept liability if its officials fail to implement or implement

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<sup>12</sup> *Id* at para 160.

<sup>13</sup> *Id* at para 174.

<sup>14</sup> *Id* at para 175

<sup>15</sup> *Id* at para 177.

<sup>16</sup> Gami Investments, Inc V. The Government of the United Mexican States, award of November 15, 2004,

<http://www.state.gov/documents/organization/38789.pdf>

regulations in a discriminatory or arbitrary fashion.”<sup>17</sup>

The Tribunal clarified what kind of maladministration could mean a violation of treatment standards. “A claim of maladministration would likely violate Article 1105 if it amounted to an ‘outright and unjustified repudiation’ of the relevant regulations.”<sup>18</sup>

### **Expropriation when shares lost value**

The Tribunal accepted that a minority shareholder could bring an expropriation claim under NAFTA.<sup>19</sup>

However, the Tribunal dismissed the argument and stated that GAMI’s shares had not been expropriated. It analyzed the issue and found “...likely that the Expropriation Decree was inconsistent with the norms of NAFTA. But Mexican conduct inconsistent with the norms of NAFTA is only a breach of NAFTA if it affects interests protected by NAFTA. GAMI’s investment in GAM is protected by Article 1110 only if its shareholding was ‘taken’”.<sup>20</sup>

In this context a taking could have occurred where those shares had lost value because of measures by the State which could be deemed tantamount to expropriation.<sup>21</sup>

According to the Tribunal GAMI had not suffered a loss of that nature.

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The views expressed here should not be attributed to the organizations with which he is affiliated.

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<sup>17</sup> *Id* at para 94.

<sup>18</sup> *Id* at para 103.

<sup>19</sup> *Id* at para 29 and 33.

<sup>20</sup> *Id* at para 129.

<sup>21</sup> *Id* at para 128.