Chapter 5

INVESTMENT

(1) Background of Rules

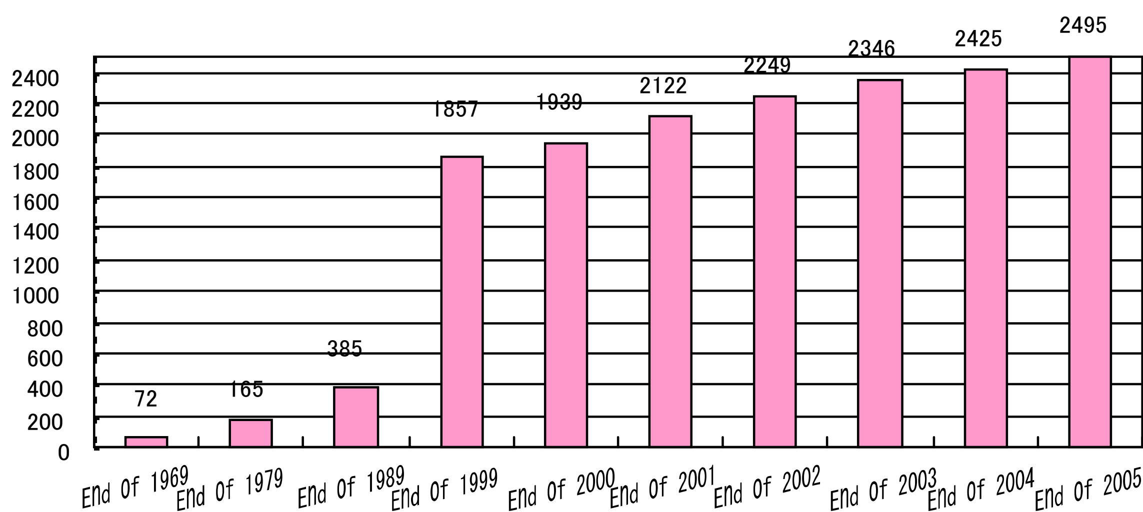
1) Increase in Foreign Direct Investment

Since the 1980s, foreign direct investment has been growing rapidly, and, along with trade, continues to serve a significant role in leading worldwide economic growth. Whereas in 1980, when the ratio of the foreign direct investment (on a cumulative basis) to GDP was 5.8% in respect of external direct investment and 5.3% in respect of inward direct investment, in 2005, the figure had grown to 23.9% and 23.7% respectively (according to UNCTAD "World Investment Report 2006").

2) Trend in Execution of Bilateral Investment Treaties

In light of the expansion of foreign direct investment, in order to protect investors and the assets thereof from risks in the host country such as sudden expropriation, countries have proceeded to execute Bilateral Investment Treaties (BITs) since the 1960s. As at the end of 2005, 2,495 such agreements were in existence. Most of the agreements developed in the form of "investment protection agreements," which are to be applied after the establishment of investments (post-establishment) in the host country.

Chart 5-1 Development in the Numbers of Investment Agreements in the World



(Source) UNCTAD "World Investment Report 2006"

3) Efforts at the OECD

With the expansion of foreign direct investment, new efforts were initiated to regulate the behavior of host countries not only in the post-establishment phase, but also in the phase when investments are initially being made in host countries. Specifically, efforts were made to lift restrictions on free cross-border investment such as foreign capital restrictions. In 1995, negotiations on the Multilateral Agreement on Investment (MAI) commenced in the OECD. The objective was to settle on a comprehensive and binding multilateral agreement regarding the liberalization and protection of investment. However, as NGOs and others opposed the MAI, claiming that state regulatory authority, in particular with regards to environmental matters, would be harmed by foreign investors, the negotiations came to a halt, and virtually broke down when France decided to withdraw from participation in the negotiations in 1998. Thus, the negotiation on the MAI was not concluded. However, ever since its early days, the OECD has been tackling the issue of international arrangements regarding investment. Although the Code of Liberalization of Capital Movements enacted in 1961 covers a wide range of investment types and provides for the liberalization of transactions except in certain cases, its enforceability is weak as it lacks dispute settlement provisions. The Guidelines for Multinational Enterprises, drafted in 1976, describe when governments of member countries should recommend that multinational enterprises behave responsibly, as their behaviors may affect the development of the world economy. The guidelines were subsequently revised four times to add descriptions on the environment, employment relations, disclosure and new chapters on consumer interests and combating bribery, in accordance with developments of the world economy and changes in the actions of multinational enterprises. Upon their revision in 2000, National Contact Points were established to promote the Guidelines, handle enquiries and help to resolve issues. However, the guidelines themselves are not legally binding and their application and implementation are left to the discretion of each enterprise.

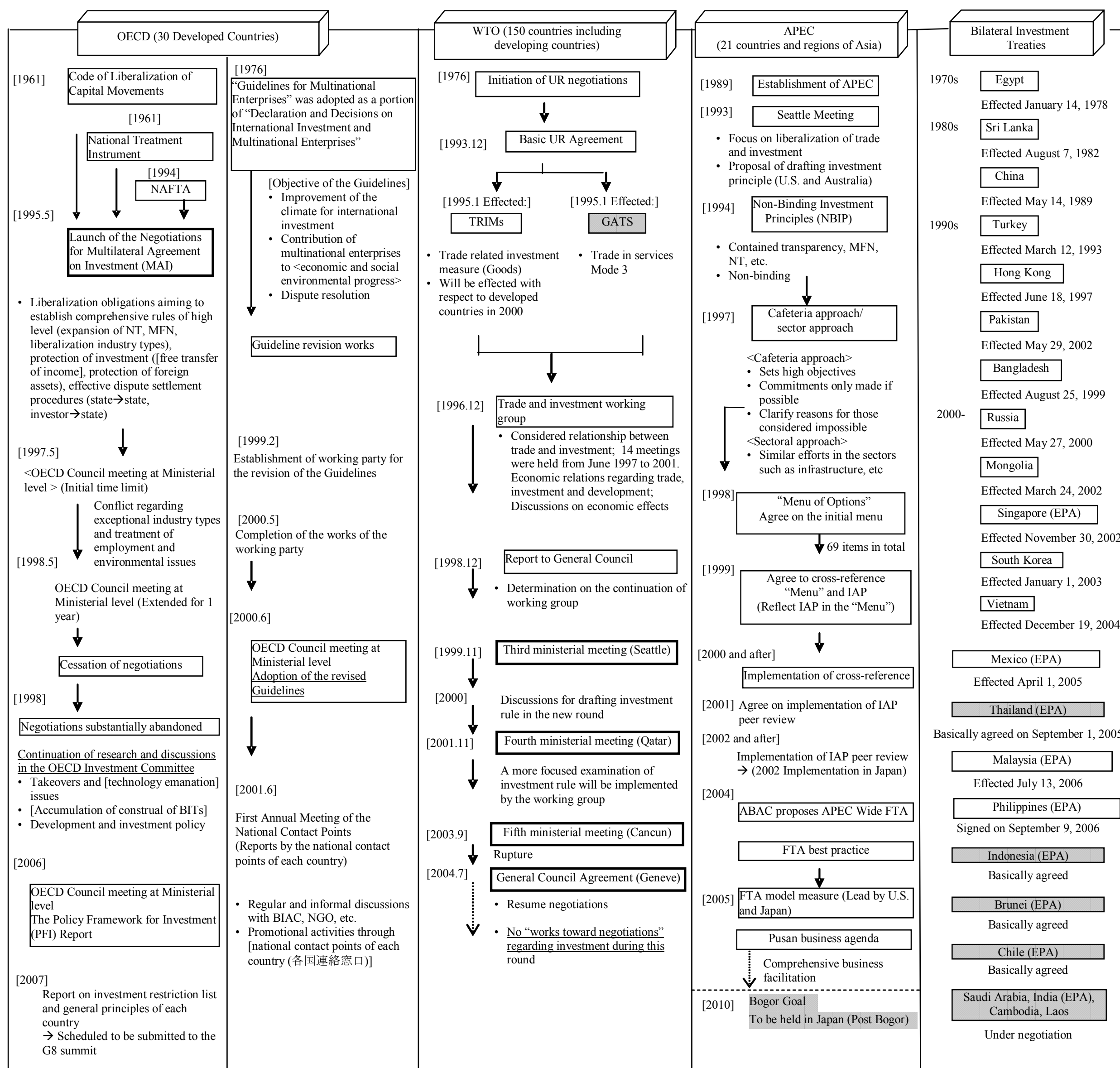
4) The Energy Charter Treaty

An example of efforts made in an individual sector is the Energy Charter Treaty, the negotiations of which were initiated by European countries in order to protect energy-related investments, particularly in the former Soviet Union. The Energy Charter Treaty was signed in 1994 and became effective in 1998. The three pillars of the Energy Charter Treaty are the provisions on the trade in goods, investment rules and energy transport. Although limited to energy-related investments, it contains elements of so-called investment protection agreements. Japan signed the treaty in 1995 and ratified it in 2002. Each country of the former Soviet Union continues to participate in the treaty following the collapse of the Soviet Union, but the treaty is treated as being provisionally applied to Russia since Russia has signed but not yet ratified the treaty.

5) Efforts at the WTO

At the WTO Singapore ministerial meeting in 1996, it was decided to consider whether the investment sector should be included as a new area for negotiation in the WTO framework, along with trade facilitation, transparency of governmental procurement and competition. Subsequently, discussions in the WTO on possible negotiations regarding “trade and investment” were led primarily by developed countries while they closely watched the progress of the discussions on the MAI at the OECD (which failed in 1998). It was agreed at the fourth ministerial meeting in 2001 to subsequently initiate negotiations if a clear consensus on negotiation modality on “trade and investment” could be obtained at the fifth ministerial meeting. From April 2002, the Working Group on trade and investment held meetings to discuss the elements (e.g., scope and definitions, transparency), contained in the Doha Declaration. However, due to strong opposition from developing countries to establishing rules regarding investments within the WTO framework, commencement of negotiations was not actually agreed at the fifth ministerial meeting.

Chart 5-2 Developments in the Organization of Environment for International Investments



(2) Overview of Legal Disciplines

1) Traditional Investment Protection Agreements and NAFTA Type Investment Liberalization Agreements

In the past, BITs were executed primarily with a view to protecting investors of developed countries and their investments in a developing country where the rule of law has not yet been established, from legal and political risks including expropriation by the government of the developing country (the country receiving the investments, sometimes referred to as the host country) or arbitrary operation of laws, thus securing the proper treatment of the investors. These agreements are of the type usually referred to as "investment protection agreements," major elements of which are post-establishment national treatment and most-favored-nation treatment, conditions on expropriation and compensation, free transfer of funds relating to investment, dispute settlement between contracting party countries and between investors and the contracting party country, etc. Most of the approximately 2,500 investment agreements currently existing in the world are "investment protection agreements."

A new approach to investment agreements that emerged in the 1990s held that they should address entry barriers to investment such as foreign capital restrictions in addition to providing post-establishment protection. Investment agreements reflecting this approach have been executed. Such investment agreements provide national treatment and most-favored-nation treatment during the pre-investment phase as well as the post-establishment phase and prohibit "performance requirements," which are considered to have a distorting effect on investments. These provisions are mostly included in FTAs/EPAs as a chapter on investment. A typical example is the investment chapter in NAFTA. These may be referred to as "investment protection/liberalization agreements."

2) Major Provisions in Investment Agreements

As previously mentioned, investment agreements can be classified into 2 types: "investment protection agreements" and "investment protection/liberalization agreements," which contain provisions relating to both investment protection and liberalization. This section will provide an overview of the major elements of "investment protection/liberalization agreements." However, elements contained in investment agreements vary among agreements, and all elements mentioned hereunder are not necessarily included in all investment agreements.

(i) National Treatment (NT) and Most-Favored-Nation Treatment (MFN)

A commonly used provision in these agreements is that each party shall accord to investors of the other party and to their investments national treatment or most-favored nation treatment with respect to all investment activities, which include the "establishment, acquisition, expansion, management, conduct, operation, maintenance, use, enjoyment and sale or other disposition of investments." In the case of investment protection agreements, because NT or MFN treatment is accorded in the post-establishment phase, the terms "establishment, acquisition, expansion" are often excluded and such agreements provide "national treatment or most-favored nation treatment with respect to management, conduct…or other disposition."

In the case of the WTO, which has multiple member countries, MFN treatment is a principle under which a Party must "accord all other Members treatment no less favorable than that it accords to any country" while, in contrast, in the case of a BIT it is to "accord investors of the other Party and to their investments treatment no less favorable than that it accords to investors of any non-Party and to their investments with respect to investment activities".

It is natural that MFN treatment extends the favorable treatment accorded to non-party countries by a contracting party country under ordinary BITs to the other contracting party country. However, it may emerge as a point of discussion in the negotiation whether to extend the treatment accorded to a non-party country granted through FTAs/EPAs or customs unions. In some cases, treatment under FTAs/EPAs or customs unions is exempted from the MFN obligation.

(ii) Fair and Equitable Treatment

In recent years, many investment agreements, including those Japan has entered into, provide obligations to accord "fair and equitable treatment" and "full protection and security" to investors. The objective of such provisions is for the host country to accord a certain level of treatment to investors, and this treatment could be better understood in comparison with NT or MFN treatment, which is determined in relation to the treatment to other investors.

What specific treatment is deemed fair and equitable treatment, in abstract, depends on the language or the context of the provision, the purpose of the agreement, individual and specific circumstances, etc. In practice, however, discussions have centered around whether fair and equitable treatment means the minimum standard under customary international law, or more favorable treatment that exceeds such minimum standard. Some BITs are explicit in this regard using language such as "in accordance with customary international law," but other BITs do not provide any relationship with customary international law.

Article 1105, paragraph 1 of NAFTA provides an obligation to accord fair and equitable treatment "in accordance with international law." However, in the *Pope and Talbot* case it was held that because NAFTA was entered into for the purpose of building a closer economic relationship between the three countries of North America, there is not only an obligation to provide treatment consistent with the minimum standard under international law, but also obligations in addition to such minimum standard. In addition, in the *S.D. Myers* case it was held that a breach of other provisions under NAFTA automatically establishes a breach of general treatment obligations. Criticisms regarding the interpretation of this provision were raised mainly in the U.S. With a view to posing limitations on the expansive reading of this obligation, the NAFTA Free Trade Commission, in response to such criticisms, published "Notes of Interpretation of Certain Chapter 11 Provisions" on August 1, 2001 confirming that general treatment obligations do not exceed that which is required by the customary international law minimum standard for treatment of aliens, and a breach of another provision of NAFTA, or of a separate international agreement, does not establish that there has been a breach of the general treatment obligations.

Some specific examples of fair and equitable treatment are the obligation to take due care in protecting the investment assets of foreign investors, the due process obligation, prohibition of denial of justice, obligation not to frustrate the legitimate expectations of investors, etc.

(iii) Prohibition of Performance Requirements (PR)

This provision prohibits a contracting party country from imposing performance requirements that hinder the free investment activities of investors, such as export requirements, local procurement requirements, technology transfer requirements, etc., as conditions for investment and business activities of the investor in the other contracting party country. The TRIMs Agreement of the WTO agreements prohibits local content requirements and export/import equity requirements as being "investment measures that have a strong trade-distorting effect." In addition, domestic sale limit requirements, technology transfer requirements, and the nationality requirements for managements are often prohibited as falling under "performance requirements." This concept of prohibiting performance requirements is relatively new, and emerged in the discussion of MAI Agreement at the OECD, which was derailed before conclusion. Thus, ordinarily, it is not included in investment protection agreements but is included in "investment protection/liberalization agreements."

Performance requirements are usually classified in two types: absolutely prohibited items and items which are permitted if required as a condition for granting benefits. Under investment protection/liberalization agreements, the local content requirement and export equity requirement, which are strictly prohibited in the TRIMs Agreement, are treated as the former items with a view to maintaining consistency with the rules under WTO Agreement, and items such as the nationality requirements for managements and technology transfer requirement are often treated as falling in the latter category in order to leave leeway for investment inducing policies for the contracting party countries.

(iv) Approach to Liberalization Commitment

The approaches to liberalization commitments of NT, MFN and PR can be classified into two types: the approach under which NT, MFN and prohibition of PR are provided to all sectors except those which the contracting party countries list as exceptions (negative list approach) and the approach under which only those sectors and content which are inscribed in the “Schedule of Commitments” are committed (positive list approach). Because “investment protection agreements” cover only the post-investment phase, the schedule of commitments for liberalization is generally not attached. In “investment protection/liberalization agreements,” developed countries such as the U.S. tend to adopt the negative list approach, which is highly transparent and legally stable (see e.g. the chapter on investment of NAFTA), and developing countries tend to adopt the positive list approach, which is the same approach as the WTO GATS, in order to leave political leeway for foreign investment restrictions (see e.g. the chapters on investment in Australia-Thailand FTA and in India-Singapore CECA).

In the case of negative lists, two types of lists are generally prepared: lists “without standstill obligations” allow parties to “maintain” or “adopt” measures not conforming to NT, MFN and prohibition of PR obligations; and lists with “standstill and ratchet obligations” under which not only measures inconsistent with the agreement cannot be newly introduced, but also measures which do not conform to NT, MFN and PR obligations which exist at the time the agreement became effective may be “maintained,” but cannot be revised in a way that makes them more inconsistent with the agreement, and once the measures are revised in the direction to make them more consistent with the agreement, the measures cannot be made more inconsistent again (this is called as the “ratchet” obligation to indicate changes can only be made in one direction). By having the standstill obligation to cover as many sectors as possible, it is possible to reduce risks to investors from changes of the legal system (i.e. risks by which domestic systems are made less favorable). At the same time, the contracting party countries register especially sensitive sectors such as sectors relating to national security like the arms and weapons industry and nuclear power industry on the list “without standstill obligations,” and those that are not so sensitive on the list “with standstill obligations,” thereby leaving leeway for necessary restrictions as well as securing legal stability in their foreign investment policies. Specifically, the negative list adopted in the chapters on investment of NAFTA, etc., (i) the relevant sector (sub-sector), (ii) related obligations, (iii) legal grounds for the measure and (iv) a summary of the measure are inscribed, thereby helping ensure the transparency of the laws and regulations of the host country.

Chart 5-3 Example of Negative List (in the case with standstill obligations)

Sector:	Mining
Sub-Sector:	
Industry Classification:	JSIC 05Mining
Type of Reservation:	National Treatment (Article 58 and Article 98) Local Presence (Article 100)
Level of Government:	Central Government
Measures:	Mining Law (Law No.289 of 1950), Articles 17 and 87
Description:	Investment and CrossBorder Services Only a Japanese national or a Japanese legal person may have mining rights or mining lease rights.
Phase-Out:	None

Preparation of lists without standstill obligation (Annex I) and with standstill obligation (Annex II)

*** Lists for investment and services are combined into one annex in the case of Japan-Singapore**

Identification of sector
(JSIC: Japan Standard Industry Classification)

Identification of reserved obligations under agreement
(NT, MFN, LP (local presence), etc.)

Level government taking reserved measures (central or local)

Names of specific measures and provision (in this case, Article 17 and 87 of Mining Law)

Specific description of the content of reservation (in this case, content of breach of specific breaches of NT or of LP)

Description of scheduled future liberalization (Annex I only)

(v) Expropriation and Compensation

The provision on expropriation and compensation provides that when the contracting party country expropriates the investment of the investor (including nationalization), it should do so in accordance with four conditions: (i) for a public purpose, (ii) on a non-discriminatory basis, (iii) upon payment of prompt compensation and (iv) in accordance with due process of law. In addition, prompt payment of compensation in accordance with fair market value as of the expropriation should be made. This is the most basic investor protection provision.

The provision usually covers indirect measures (i.e. measures equivalent to expropriation) in addition to direct expropriation that involves transferring assets to the state. Indirect expropriation, also known as creeping expropriation, refers to actions that hinder the use of investment or income due to policy measures such as deprivation of discretionary permission and license by the government of the contracting party country and the imposition of a maximum limit of production, ultimately resulting in an outcome equivalent to expropriation. Discussions on indirect expropriation were triggered by an arbitration case in the late 1990s (*NAFTA Metalclad* case; environmental protection measures taken by a state government of Mexico allegedly constituted indirect expropriation; the Mexican government was therefore held liable for breach of obligations under the agreement, *infra* at Dispute Settlement regarding Investment): to what extent do restrictive measures of the contracting party countries constitute indirect expropriation, and to what extent should an action constitute "expropriation" which requires compensation. In reaction to this arbitral award, the recent U.S.A.-Australia FTA and U.S.A.-Chile FTA provide that indirect expropriations require a case-by-case inquiry, that considers three factors: (i) the fact that an action or series of actions by a party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred, (ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations and (iii) the character of the government action.
Except in rare circumstances, nondiscriminatory regulatory actions by a party that are

designed and applied to achieve legitimate public welfare objectives, such as the protection of public health, safety, and the environment, do not constitute indirect expropriations.

(vi) Protection from Strife

If investors have suffered loss or damage relating to their investments due to armed conflict, revolution, civil disturbance, etc., this provision guarantees treatment of such investor, with regard to indemnification or any other settlement that is no less favorable than that which is accorded to the contracting party country's own enterprises or enterprises of a non-party. This is one of the fundamental investor protection provisions.

(vii) Subrogation

This is a provision recognizing the assignment of investors' claims arising in the event investments suffer damages to the contracting party country or its designated agency by virtue of subrogation. For example, if investors suffer any damage due to a natural disaster or bankruptcy of local enterprises, such investor will make claims for payment under an insurance contract, etc., against the contracting party country or its designated insurance agency. It provides that, in such case, in order to facilitate collection of the amount by the contracting party country or such insurance agency which made payments to the investors, the contracting party country or such insurance agency may succeed and exercise the investors' rights under the agreement. As for Japan, this applies to insurance and insurance contracts provided by Nippon Export and Investment Insurance and Japan Bank for International Cooperation.

(viii) Transfers

This provision ensures that all transfers of funds relating to investments of an investor of the contracting party countries may be made freely without delay, and is essential for investors to efficiently engage in business activities.

(ix) State-to-State Dispute Settlement

In the event any dispute arises between contracting party countries over the interpretation or application of the agreement, consultation shall be first made between the party countries, and if no settlement is reached by such consultation, the dispute will be submitted to an arbitral tribunal. Since in FTAs/EPAs, it is stipulated that the provision on state-to-state dispute settlement pertains to the entire FTAs/EPAs including the chapter on investment, this provision is provided in a section which covers the entire agreement, such as the chapter on general provisions.

(x) Investment Treaty Arbitration (Investor-to-state)

This provides that if any dispute arises between the investor and the contracting party country and cannot be settled by consultation, investors may submit such investment dispute to arbitration in accordance with the arbitration rules of ICSID (International Centre for Settlement of Investment Disputes) or to UNCITRAL (United Nations Commission on International Trade). (Discussed later in "Dispute Settlement regarding Investment.") In FTAs/EPAs, it is provided in the chapter on investment.

(3) Current Status of Japan's Execution of Investment Agreements (including chapters on investment in EPAs)

As at the end of 2006, Japan had entered into 11 BITs and four EPAs with chapters on investment. This means that Japan has substantially entered into 15 investment agreements.

		Signed	Effected
(i)	Egypt	January 1977	January 1978
(ii)	Sri Lanka	March 1982	August 1982
(iii)	China	August 1988	May 1989
(iv)	Turkey	February 1992	March 1993
(v)	Hong Kong	May 1997	June 1997
(vi)	Pakistan	March 1998	May 2002
(vii)	Bangladesh	November 1998	August 1999
(viii)	Russia	November 1998	May 2000
(xi)	Mongolia	February 2001	March 2002
(x)	South Korea	March 2002	January 2003
(xi)	Vietnam	November 2003	December 2004
*	Japan-Singapore EPA	January 2002	November 2002
*	Japan-Mexico EPA	September 2004	April 2005
*	Japan-Malaysia EPA	December 2005	July 2006
*	Japan-Philippines EPA	September 2006	

The foregoing agreements which were entered into after the agreement with South Korea are "investment protection/liberalization agreements" that include NT, MFN and PR at the time of permitting investment, but their content slightly differs from one another.

Chart 5-4 Elements of Japan's Investment Agreements

			Japan's Previous Investment Protection Agreements	Japan-Singapore EPA (Chapter on Investment)	Japan-Korea Investment Agreement	Japan-Vietnam Investment Agreement	Japan-Mexico EPA (Chapter on Investment)	Japan-Malaysia EPA (Chapter on Investment)	Japan-Philippines EPA (Chapter on Investment)
Liberalization of Investment	National Treatment before Investment		×	○	○	○	○	○	○
	Most-Favored-Nation Treatment before Investment		×	×	○	○	○	○	○
	Prohibition of Performance Requirements		×	○	○	○	○	○ Confirmation of obligations under TRIMs	○
	*○=Absolutely prohibited, ●=Permitted if required as a condition for granting interest	Export Requirement	—	○	○	○	●	×	○
		Local Content Requirement	—	○	○	○	○	○	○
		Local Procurement Requirement	—	○	○	○	○	○	○
		Export and Import Balance Requirement	—	○	○	○	○	○	○
		Domestic Sale Restriction Requirement	—	○	○	○	○	×	○

	Item							
	Technology Transfer Requirement	—	●	●	●	●	×	●
	Head Office Establishment Requirement	—	●	●	●	×	×	●
	Research and Development Requirement	—	●	●	●	×	×	●
	Specific Region Supply Requirement	—	●	●	●	●	×	●
	Local Citizen Employment Requirement	—	×	●	×	×	×	●
	Officers' Nationality Requirement	—	×	○	●	○	×	○
	Approach of Commitment	—	Negative	Negative	Negative	Negative	Negative	Negative
Protection of Investment	National Treatment after Investment	○	○	○	○	○	○	○
	Most-Favored-Nation Treatment after Investment	○	×	○	○	○	○	○
	Fair and Equitable Treatment	○	○	○	○	○	○	○
	Expropriation and Compensation	○	○	○	○	○	○	○
	Protection from Strife	○	○	○	○	○	○	○
	Transfers	○	○	○	○	○	○	○
	Subrogation	○	○	○	○	○	○	○
	Investment Treaty Arbitration	○	○	○	○	○	△ (Excludes NT/PR)	× Reconsultation
	Interstate Dispute Settlement	○	○	○	○	○	○	○

(4) Investment Agreements of other Countries (including chapters on investment in FTAs/EPAs)

Chart 5-5 Elements of Investment Agreements of other Countries

			U.S.A.-Australia FTA	NAFTA	Australia-Thailand FTA	EFTA-South Korea Investment Agreement
Liberalization of Investment	National Treatment before Investment		○	○	○	○
	Most-Favored-Nation Treatment before Investment		○	○	×	○
	Prohibition of Performance Requirements		○	○	×	×
	*○=Absolutely prohibited, ●=Permitted if required as a condition for granting interest	Export Requirement	●	●	—	—
		Local Content Requirement	○	○	—	—
		Local Procurement Requirement	○	○	—	—
		Export and Import Balance Requirement	○	○	—	—
		Domestic Sale Restriction Requirement	○	○	—	—
		Technology Transfer Requirement	●	●	—	—
		Head Office Establishment Requirement	×	×	—	—
		Research and Development Requirement	×	×	—	—
		Specific Region Supply Requirement	●	●	—	—
		Local Citizen Employment Requirement	×	×	—	—
		Officers' Nationality Requirement	○	○	—	—

	Approach of Commitment	Negative	Negative	Positive	Negative
Protection of Investment	National Treatment after Investment	○	○	○	○
	Most-Favored-Nation Treatment after Investment	○	○	○	○
	Fair and Equitable Treatment	○	○	○	○
	Expropriation and Compensation	○	○	○	○
	Protection from Strife	○	○	×	○
	Transfers	○	○	○	○
	Subrogation	×	×	Limited to extreme risks	○
	Investment Treaty Arbitration	×	○	○	○
	Interstate Dispute Settlement	○	○	○	○

Column ♦ Relationship between the Chapter on Investment and the Chapter on Services

When a chapter on investment is to be included in an FTA/EPA, unlike when executing an investment agreement, the relationship between the chapters on investment and services is one of the issues that should be resolved. In the chapter on services, Mode 3 (provision of services through a commercial presence established in the host country), which is about investments in the service industry, commitments are made on NT, MA and MFN with respect thereto in such chapter on services. On the other hand, in the chapter on investment commitments are made on NT, PR and MFN with respect to all industry types, without making any distinction between industry types such as service and manufacturing industries. Therefore, the issue arises as to whether to make a commitment for NT and MFN for investments in service industries in the chapter on investment or in the chapter on services. U.S. FTAs such as NAFTA organize commitments regarding investments in all industry types in the chapter on investment, and the chapter on services only contains commitments on Modes 1, 2 and 4. In contrast, in agreements of the EFTA and ASEAN states, NT and MFN in the chapter on investment do not apply to the service industry, and commitments regarding the service industry are organized in the chapter on services. This relates to the choice of the approach to the commitments in both chapters. The chapter on investment in FTAs/EPAs often adopts the negative list approach, while the chapter on services often adopts the positive list approach, following GATS. Developed countries tend to cover service industry investment in the chapter on investment, which employs the negative list approach, and thereby achieve a high level of liberalization and transparency. Developing countries, on the other hand, coming from a viewpoint of protecting domestic industry, claim that with respect to the service industry, which is more sensitive, commitments should be made using the positive list approach. This often constitutes a point of discussion in the negotiations along with the negative and positive approaches of the list. However, since the determination of whether a business is a service industry or non-service industry is extremely difficult to distinguish in practice and because a breach of NT or MFN commitments in a chapter on services cannot become subject to investor-to-state dispute settlement due to a lack of investor-to-state dispute settlement provisions in such chapter, developed countries led by the U.S. adopt the approach in which NT and MFN commitments including those pertaining to the service industry are made in the chapter on investment.

Column ♦ Direct Investment and Portfolio Investment

One of the issues to be discussed in the negotiations is the scope of the investment assets to be covered by the investment agreements. In particular, many developing countries in Asia, from their experience in the Asian currency crisis in the late 1990s, display extreme wariness about speculative investments involving the purchase of a significant amount of shares from the securities markets and short-term resale of such shares. In contrast to "direct investments," which involve establishing plants and local corporations in the host countries and engaging in long-term business, such investments are referred to as "portfolio investments." Developing countries may claim that such portfolio investments should be excluded from the scope of investment agreements, or that investment agreements only cover direct investments. IMF Balance of Payments Manual (Fifth Edition) defines direct investment as "international investment that reflects the objective of a resident entity (direct investor) in one economy obtaining a lasting interest in an enterprise resident (direct investment enterprise) in another country" and defines a direct investment enterprise as "an incorporated or unincorporated enterprise in which a direct investor owns 10 percent or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise)." However, as the types of investments are diversifying, it is becoming extremely difficult to determine whether or not an investment is speculative merely from the ownership percentage of shares or voting rights. It is not rare that a 10% or lower interest in shares could be held by investors over a long period, or an investment fund could obtain and acquire the majority of shares in a corporation, sell them off and gain profits in a short period of time.

Thus, investment agreements usually cover "all assets," regardless of the ownership percentage of shares or voting rights, and safeguard provisions are incorporated to cope with the event that the host country becomes immersed in a serious international payment balance crisis or macro-economic crisis.

Dispute Settlement regarding Investment

(1) Backgrounds of the Rules

Regional trade agreements (FTAs/EPAs) and bilateral investment treaties (BITs) provide procedures under which a party country may request a decision from a dispute settlement body (an arbitral panel or a body consisting of representatives of the contracting parties) against the other party country if any dispute arises in connection with the application or interpretation of the agreement. However, as for “state-to-state” dispute settlement procedures, since a highly developed WTO dispute settlement procedures (formerly GATT dispute settlement procedures) already exists, covering a wide scope of disputes regarding trade and investment, it is rare that “state-to-state” dispute settlement procedures are included in FTAs/EPAs and BITs.

On the other hand, most FTAs/EPAs and BITs provide an “investor-to-state” dispute settlement procedures for investment cases, under which the investor may submit a dispute with the host country to arbitration when the investor suffers any damages due to a breach of any provision of the agreement by the host country, and may receive pecuniary compensation from the host country if the arbitration body finds any breach of the agreement by the host country[1]. In the case of WTO disputes, because “state-to-state” disputes are filed primarily for the purpose of causing the country complained against to bring its regulations and practices into conformity with the agreement and reaching a complete and permanent resolution, such disputes are usually expensive and time consuming. In contrast, in the investment area, since investors are generally seeking to limit the damages to their business by prompt collection of invested funds rather than a fundamental resolution of the issues in dispute, “investor-to-state” dispute settlement that provides pecuniary compensation or restitution for dispute resolution is responsive to the real needs of investors.

In addition, if investment protection agreements or individual concession agreements do not have any special arrangements for dispute resolution between the investor and the host country, investors normally have no choice but to file a dispute against the host country in the domestic court of such host country. There is a possibility that the investor will receive an unfavorable decision as a result of being foreign. It would be difficult for investors to submit a dispute to arbitration, because submission to arbitration normally requires an agreement between the parties regardless of whether they are states or individuals. Therefore, the “investor-to-state” dispute settlement provisions in many FTAs/EPAs and BITs provide an advance agreement of the contracting party countries to submit disputes to arbitration (in the form of an advance comprehensive agreement on arbitration submission), in order to enable investors to submit such investment dispute, if any, to arbitration immediately without obtaining individual consent to arbitration from the government of the host country.

In this way, the dispute settlement provisions assume a role of reducing risks in foreign investment by ensuring the opportunity for investors to receive fair decisions.

(2) Use of the Rules

(i) Changes in the Number of Cases Submitted to Arbitration Institutions

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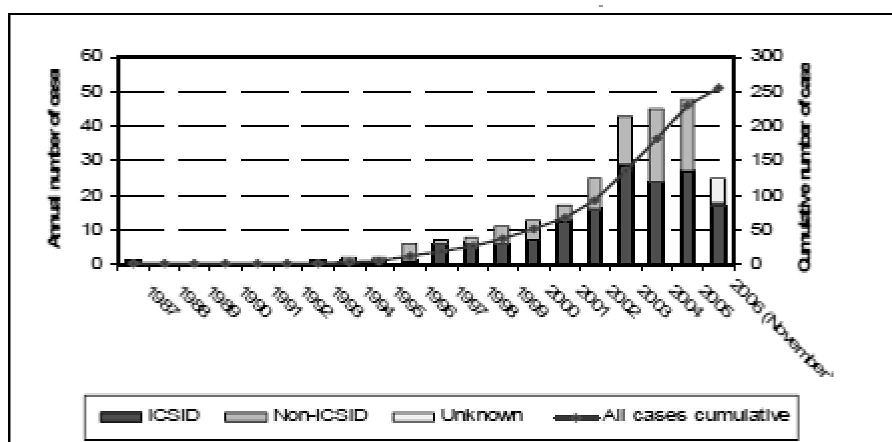
1 (Note) Some agreements between developed countries do not contain investor-to-state dispute settlement provisions, e.g. the U.S.A.-Australia FTA. However, the U.S.A.-Australia FTA provides that if a party considers that there has been a change in circumstances affecting the settlement of disputes and that, in light of such change, the parties consider allowing an investor to submit to arbitration, the party may request consultation with the other party (Article 11.16, paragraph 1).

Countries began to enter into BITs in the 1960s. At that time, such BITs generally already provided for "investor-to-state" dispute settlement procedures in relation to investment. However, due to concerns over the effectiveness of arbitration procedures and worries that initiating an arbitration process would damage relations with the host country, the number of arbitration cases submitted by investors initially remained at a very low level. In the "*Ethyl* case" in 1996, the Canadian government paid a settlement to a U.S. enterprise that had submitted a dispute to arbitration claiming that environmental regulation by the Canadian government constituted "expropriation" under NAFTA. This settlement gained much attention, as did the recently commenced (in 1995) multilateral investment agreement negotiations at the OECD. Both contributed to an increased interest in the use of arbitration in disputes related to investments, and thus, the number of cases submitted to arbitral tribunals drastically increased from the late 1990s.

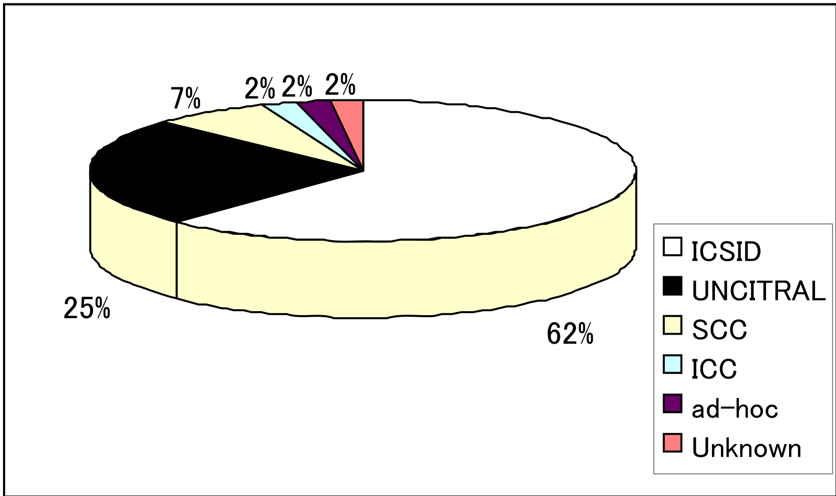
Chart 5-6 Trend of Referral to Arbitration (1987-November 2006)



(Source: Reference of UNCTAD)

The primary arbitration procedures designated by agreements are the arbitration procedures of (i) the International Centre for Settlement of Investment Disputes (ICSID), (ii) United Nations Commission on International Trade Law (UNCITRAL), (iii) International Chamber of Commerce (ICC) and (iv) Arbitration Institute of the Stockholm Chamber of Commerce (SCC). The most frequently used procedure is that of ICSID, which was established as an entity of the World Bank group pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) which entered into force in 1966. 60% or more of past arbitration cases were submitted to ICSID.

Chart 5-7 Percentage of Cases Submitted to Major Arbitration Procedures
(- November 2006/255 cases in total)



(Source: Reference of UNCTAD)

2) Countries involved in Arbitration Cases

According to the summary prepared by UNCTAD, in connection with "investor-to-state" dispute cases submitted in the past, the country which was the "respondent" most frequently was Argentina (42 cases), followed by Mexico (17 cases), the Czech Republic (11 cases) and the U.S.A. (11 cases). A significant number of cases were filed against Argentina compared to other countries due to the political disruption amidst the financial crisis after the end of 2001. As for the Czech Republic, the non-performing loan issues in the financial sector, triggered by the currency crisis in 1997, caused the large number of disputes. Presumably there are many cases in which Mexico or the U.S.A. is the respondent because Chapter Eleven of NAFTA provides a detailed "investor-to-state" dispute settlement procedure.

Chart 5-8 Number of Cases in which each Country was the Respondent (- November 2006)

Rank	Respondent	Number of Cases
1	Argentina	42
2	Mexico	17
3	Czech Republic	11
4	U.S.A.	11
5	Moldova	9
6	Russia	9
7	India	9
8	Ecuador	8
9	Egypt	8
10	Canada	7
11	Poland	7
12	Romania	7
13	Ukraine	6
14	Chile	4

15	Congo	4

(Source: Reference of UNCTAD)

3) Status of Use of Arbitration Procedures by Enterprises

According to the summary prepared by UNCTAD, the industry sector employing arbitration procedures most frequently is the tertiary sector of industry (including electrical power, communications, securities, water supplies, waste management) at 42%, followed by secondary industry at 29% and primary industry at 29%.

The past cases involving primary industry all pertain to the mining industry and petroleum and gas excavation. In particular, development of energy sources requires an enormous amount of investment, and most of the resource-generating countries are developing countries and often lack social and political stability, presumably resulting in the high demand for investment protection. Therefore, in addition to the provisions in FTAs/EPAs and BITs, in recent years the dispute settlement provisions of the "Energy Charter Treaty" (a multilateral international treaty) have been employed to protect investment in the energy sector. (Significant arbitration cases by industry sector are summarized in the following "Reference 2.")

(3) Overview of Legal Disciplines

(i) Framework of the Investor-to-State Dispute Settlement Procedures under FTAs/EPAs and BITs

The investor-to-state arbitration procedures prescribed in the chapters on investment in FTAs/EPAs and BITs vary between the agreements, but generally provide for the process below:

(i) Investment Dispute Covered

If the contracting party country breaches any obligation under the agreement such as those concerning expropriation or fair and equitable treatment and the investor consequently suffers any damage, this dispute is covered by the investor-to-state dispute settlement procedures. Some old type BITs broadly define the subject disputes as "any legal dispute that may arise out of investment made by an investor of either Contracting Party" (Agreement between Japan and Mongolia concerning the Promotion and Protection of Investment, Article 10.1), while some limit the coverage of dispute settlement to a "dispute concerning amount of compensation" in the case of expropriation (Agreement between Japan and The People's Republic of China Concerning the Encouragement and Reciprocal Protection of Investments, Article 11.2).

(ii) Consultation by Investors and Counterparty Governments (Party Country to the Dispute)

A dispute is not immediately submitted to arbitration on its occurrence. Instead, there is ordinarily a consultation period of between three to six months before submission to arbitration.

(iii) Submission of a Claim to Arbitration

It is generally provided that investors may submit a dispute to arbitration if such dispute could not be settled through consultation. Where there is no agreement, consent of the disputing party country is required to submit a specific investment dispute to arbitration, but many agreements provide prior consent to submission to arbitration in the agreement (in the form of prior comprehensive

consent). It is often provided that investors can choose from among arbitration procedures in accordance with ICSID (in the case both the home country of the investor and the disputing party country are ICSID member countries), ICSID Additional Facility Rules (in the case either the home country of the investor or the disputing party country is an ICSID member country) or UNCITRAL rules. Sometimes, ICC Arbitration Rules, SCC Arbitration Rules or other rules , are added to the foregoing (see "Framework of Major Arbitration Bodies/Arbitration Rules" below).

In addition, submission to arbitration is usually conditional upon no lawsuit regarding the same dispute being filed with a domestic court. Likewise, filing the same case with a domestic court after submission to arbitration is normally prohibited. These conditions are intended to prevent the claimant-investor from obtaining double compensation and avoid conflicting decisions by the arbitral tribunal and the domestic court regarding the same dispute.

(iv) Selection of Arbitrators and Constitution of Arbitral Tribunal

After the selection of arbitration body and rules, the arbitration tribunal is constituted by selecting the arbitrators. The arbitration is then conducted in accordance with the rules of individual arbitration bodies or rules selected by investors. However, the relevant agreement may add amendments regarding the selection method of the arbitrator, information disclosure, consolidation of claims, provision of opportunity for third parties to state opinions, etc (see, for example, the chapter on investment in NAFTA).

(v) Decision regarding Jurisdiction of Arbitration

After constituting the arbitral tribunal, it is first determined whether such arbitral tribunal has jurisdiction over the investment dispute. This is always a significant issue relating to the definition of the investment dispute to be covered as stated in (i).

(vi) Decision on Merits

If it is determined that the arbitral tribunal has jurisdiction, then the tribunal will judge the merits of the case and, if it finds there was a breach, determine the amount of compensation.

(vii) Determination of Arbitral Award

Unlike state-to-state dispute settlement, if the claim of an investor is upheld, the arbitral award ordinarily takes the form of pecuniary compensation or restitution. The arbitral award is final and binding upon the parties. The arbitral award is usually rendered only once, but under the ICSID Convention, Regulations and Rules, revision or annulment of the arbitral award may be made under certain circumstances (Articles 51 and 52 of the ICSID Convention, Regulations and Rules). In addition, annulment is sometimes requested under the arbitration law of the country in which the arbitration tribunal is constituted or Article V of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).

(viii) Enforcement of Awards

The ICSID Convention, in its text rather than its Arbitration Rules, provides for the enforcement of awards (Articles 53-55). Most losing parties have implemented the unfavorable awards, for example, by paying compensation to the investor. In cases under any arrangement other than the ICSID Convention and its Arbitration Rules, in general, awards are enforceable pursuant to the domestic laws of the Contracting States according to the New York Convention.

2) Summary of Major Arbitral Bodies and Arbitration Rules

	ICSID Convention (the "Convention") and the Arbitration Rules (the "Rules")	ICSID Additional Facility Rules
Legal Foundation	- The International Centre for Settlement of Investment Disputes (ICSID) is a permanent arbitration institution and is one of the organizations of the World Bank Group. It is located in the U.S. (Washington D.C.). - The ICSID Convention came into force in 1966. There were 156 Contracting States as of 2006. - The ICSID Convention (Total 75 Articles) provides for arbitration in Articles 36-55. - The "Arbitration Rules" provide the details regarding arbitration proceedings.	- In 1978, the Administrative Council granted the ICSID Secretariat the authority to administer the settlement of disputes which are not covered by the Convention, such as in cases where the party is not a Contracting State. - The ICSID Additional Facility Rules have three schedules. Schedule C provides for arbitration between a Contracting State and a Non-contracting State.
Subject Matter	- Disputes regarding investments between the nationals of a Contracting State and other Contracting States.	- Investment disputes in which either party is a Non-contracting State or national of a Non-contracting State. (Article 2)
Commencement of Arbitration Proceedings	- The date on which the Secretary-General notifies the parties that all the arbitrators have accepted their appointment. (Rules, Rule 6)	- Sending a request in writing to the Secretariat. (Schedule C, Article 2)
Appointment of Arbitrators	- Three arbitrators, in principle. (Convention, Article 37,(2) (b)) - If the parties do not appoint the arbitrators, the Chairman of the Administrative Council shall appoint such from the Panel of Arbitrators. (Convention, Article 38, Article 40 (1)) - The Tribunal shall be the judge of its own competence. (Convention, Article 41 (1)) - If the arbitrators are appointed by the Chairman, none of them shall be a national of the State party to the dispute. (Article 52, (3))	- Three arbitrators, in principle. (Schedule C, Article 6, (1)) - One or an uneven number is acceptable. (Schedule C, Article 6, (3)) - If the parties do not agree, the Chairperson of the Administrative Council shall appoint (Schedule C, Articles 9 and 10) - The majority of the arbitrators shall be, in principle, nationals of States other than the State party to the dispute. (Schedule C, Article 7)

Tribunal Proceedings	- Arbitration proceedings shall be held at the seat of the Centre, in principle. (Convention, Article 62, Rules, Rule 13) - In the absence of the parties' agreement on the applicable law, the Tribunal shall apply the law of the Contracting State party to the dispute and such rules of international law as may be applicable. (Convention, Article 42, (1)) - The parties are not allowed to institute in a court of the States an objection contrary to the award. (Convention, Article 53, (1)) - In accordance with the agreement between the parties, one or two languages may be used in the proceeding. If it is not agreed upon, it will be selected from the official languages of the ICSID. (Rules, Rule 22) - Provisional measures for the preservation of its rights may be recommended by the Tribunal. (Rules, Rule 39) - An annulment of the Tribunal shall be tried by the Committee constituted by three persons appointed from the Panel of Arbitrators by the Chairman of the Administrative Council. (Convention, Article 52)	- Arbitration proceedings may be held in any States that are parties to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards. (New York Convention) (Schedule C, Article 19) - The place of arbitration shall be determined by the Arbitral Tribunal. (Schedule C, Article 20) - In accordance with the agreement between the parties, one or two languages may be used in the proceeding. If it is not agreed upon, it will be selected from the official languages of the ICSID. (Schedule C, Article 30) - Provisional measures for the preservation of its rights may be ordered or recommended. (Schedule C, Article 46) - As to the applicable law, the rules of law designated by the parties as the law applicable to the substance of the dispute shall be applied. In the absence of such agreement, it shall be determined by the conflict of laws rules, and the law which the Tribunal considers applicable in light of international law shall be applied. (Schedule C, Article 54)
Award	- Decided by a majority of the votes of all its members. (Convention, Article 48) - The award shall be binding on the parties. (Convention, Article 53) - In certain circumstances, either party may request revision or annulment of the award. (Convention, Articles 51 and 52)	- Shall be made by a majority of the votes of all its members. (Schedule C, Article 24) - The award shall be final and binding on the parties. (Schedule C, Article 52 (4))

	UNCITRAL Arbitration Rules	ICC Rules of Arbitration
Authorizing Law, etc.	- The United Nations Commission on International Trade Law (UNCITRAL) was established by the General Assembly in 1996. It is located in Austria (Vienna). - UNCITRAL itself is an organization which provides rules, and does not conduct arbitration proceedings. - The UNCITRAL Arbitration Rules were adopted in 1976. (The UNCITRAL Model Law on International Commercial Arbitration was adopted in 1985.)	- The International Chamber of Commerce (ICC) was founded in 1923. It is located in France (Paris). - Currently, 7,400 companies and associations from 130 countries have joined as members. - The current "ICC Rules of Arbitration (the Rules of Arbitration of the International Chamber of Commerce)" came into effect in January 1998.
Subject Matter	Disputes arising in the context of international commercial relations, such as commercial contracts, etc. (Resolution)	Business disputes of an international character. (Article 1)
Commencement of Arbitration Proceedings	The date on which the notice of arbitration is received by the respondent. (Article 3.2)	The date on which the Request is received by the Secretariat. (Article 4.2)
Appointment of Arbitrators	- Three arbitrators, in principle. (Article 5) - If three arbitrators are to be appointed, each party shall appoint one arbitrator. The two arbitrators thus appointed shall choose the third arbitrator. (Article 7.1) - If the parties have not reached agreement on the choice of arbitrator(s), they shall be appointed by the appointing authority agreed by the parties or the appointing authority designated by the Secretary-General of the Permanent Court of Arbitration at The Hague. (Article 6.2) - For appointment of a sole arbitrator or the third arbitrator, a nationality other than the nationalities of the parties shall be taken into account. (Articles 6.4 and 7.3)	- A sole arbitrator, in principle. (Article 8.2) - Where the parties have agreed that the dispute shall be settled by a sole arbitrator, they may, by agreement, nominate the sole arbitrator. However, the ICC's confirmation is necessary. - Where the dispute is to be referred to three arbitrators, each party shall nominate, respectively, one arbitrator for the ICC's confirmation. The third arbitrator shall be appointed by the ICC, in principle. - Where a party fails to nominate an arbitrator, the appointment shall be made by the ICC. (Articles 8.3 and 8.4) - The sole arbitrator or the chairman of the Arbitral Tribunal shall be of a nationality other than those of the parties, in principle. (Article 9.5) - Every arbitrator must be and remain independent of the parties involved in the arbitration. (Article 7) - Arbitrators are obligated to disclose [any facts or circumstances which might

		be of such a nature as to call into question the arbitrator's independence in the eyes of the parties]. (Article 7)
Tribunal Proceedings	- The place of arbitration shall be determined by the arbitral tribunal if the parties have not agreed upon such. (Article 16.1) - The place of arbitral proceedings shall be determined at the arbitral tribunal's discretion. (Articles 16.2 and 16.3) - The arbitral tribunal shall have the power to rule on objections that it has no jurisdiction. (Article 21.1) - The language to be used in the proceedings shall be determined by the arbitral tribunal if the parties have not agreed upon such language. (Article 17.1) - If the parties have failed to designate the applicable law, the arbitral tribunal shall determine such which it considers applicable. (Article 33.1) - The arbitral tribunal may take any interim measures. (Article 26.1)	- The place of arbitration shall be fixed by the ICC unless agreed upon by the parties. (Article 14) - The Arbitral Tribunal may conduct hearings and meetings at any location it considers appropriate unless otherwise agreed by the parties. (Articles 14.2. and 14.3) - Any decision as to the jurisdiction of the Arbitral Tribunal shall be taken by the Arbitral Tribunal with the condition that an arbitration agreement exists. (Article 6.2) -The Arbitral Tribunal shall determine the language or languages of the arbitration unless the parties have agreed upon such. (Article 16) - The Arbitral Tribunal shall apply the rules of law which it determines to be appropriate in the absence of any agreement between the parties on the applicable law. (Article 17.1) - Persons not involved in the proceedings shall not be admitted to hearings. (Article 21.3) - The Arbitral Tribunal may order any interim or conservatory measure. (Article 23) - The parties may constitute an exclusionary agreement. (Article 28.6)
Award	- Shall be made by a majority of the arbitrators. (Article 31.1) - The award shall be final and binding on the parties. (Article 32.2)	- An Award is given by a majority decision. If there be no majority, the Award shall be made by the chairman of the Arbitral Tribunal alone. (Article 25.1)

	Arbitration Rules of the SCC Institute
Authorizing Law, etc.	- The Arbitration Institute of the Stockholm Chamber of Commerce (SCC Institute) was established in 1917 as an entity affiliated with the Stockholm Chamber of Commerce. - The current Arbitration Rules of the Arbitration Institute of the Stockholm

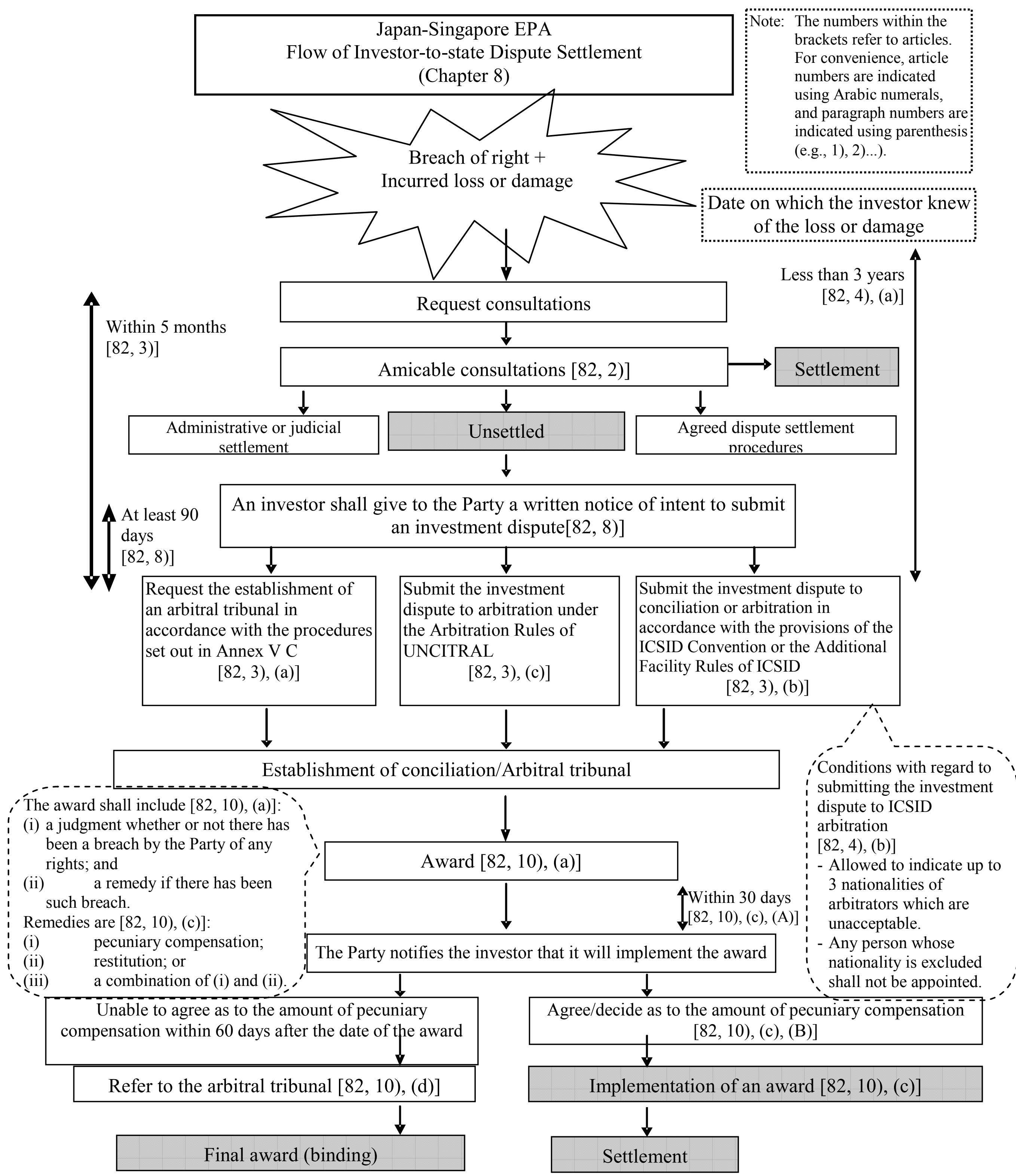
	Chamber of Commerce came into force on January 1, 2007.
Subject Matter	- No particular provision.
Commencement of Arbitration Proceedings	- Arbitration is initiated by the Claimant filing a Request for Arbitration with the SCC Institute. (Article 2)
Appointment of Arbitrators	- The parties are free to agree on the number of arbitrators. Where the parties have not agreed on the number of arbitrators, the Arbitral Tribunal shall consist of three arbitrators, unless the Board decides that the dispute is to be decided by a sole arbitrator. (Article 12) - Where the Arbitral Tribunal is to consist of a sole arbitrator, the parties shall jointly appoint the arbitrator. If the parties fail to make the appointment, the arbitrator shall be appointed by the Board. (Article 13.2) - Where the Arbitral Tribunal is to consist of more than one arbitrator, each party shall appoint an equal number of arbitrators and the Chairperson shall be appointed by the Board. Where the parties fail to agree on the arbitrator(s) appointed by the counterparty, the Board shall make the appointment of all arbitrators. (Article 13.3) - The sole arbitrator or the Chairperson of the Arbitral Tribunal shall be of a different nationality than the parties, in principle. (Article 13.5) - Every arbitrator must be impartial and independent. (Article 14.1) - Arbitrators are obligated to disclose any circumstances which may give rise to justifiable doubts as to her/his impartiality or independence. (Article 14.2)
Tribunal Proceedings	- Unless agreed upon by the parties, the Board shall decide the seat of arbitration. (Article 20.1) - The Arbitral Tribunal may conduct hearings at any place which it considers appropriate. (Article 20.2) - Unless agreed upon by the parties, the Arbitral Tribunal shall determine the

	language or languages of the arbitration. (Article 21.1) - The Arbitral Tribunal shall apply the law or rules of law which it considers to be most appropriate in the absence of an agreement on the applicable law by the parties. (Article 22.1) - Hearings will be in private. (Article 27.3) - The Arbitral Tribunal may grant any interim measures it deems appropriate. (Article 32)
Award	- Shall be made by a majority of the arbitrators; if failing a majority, by the Chairperson. (Article 35.1) - An award shall be final and binding on the parties when rendered. (Article 40)

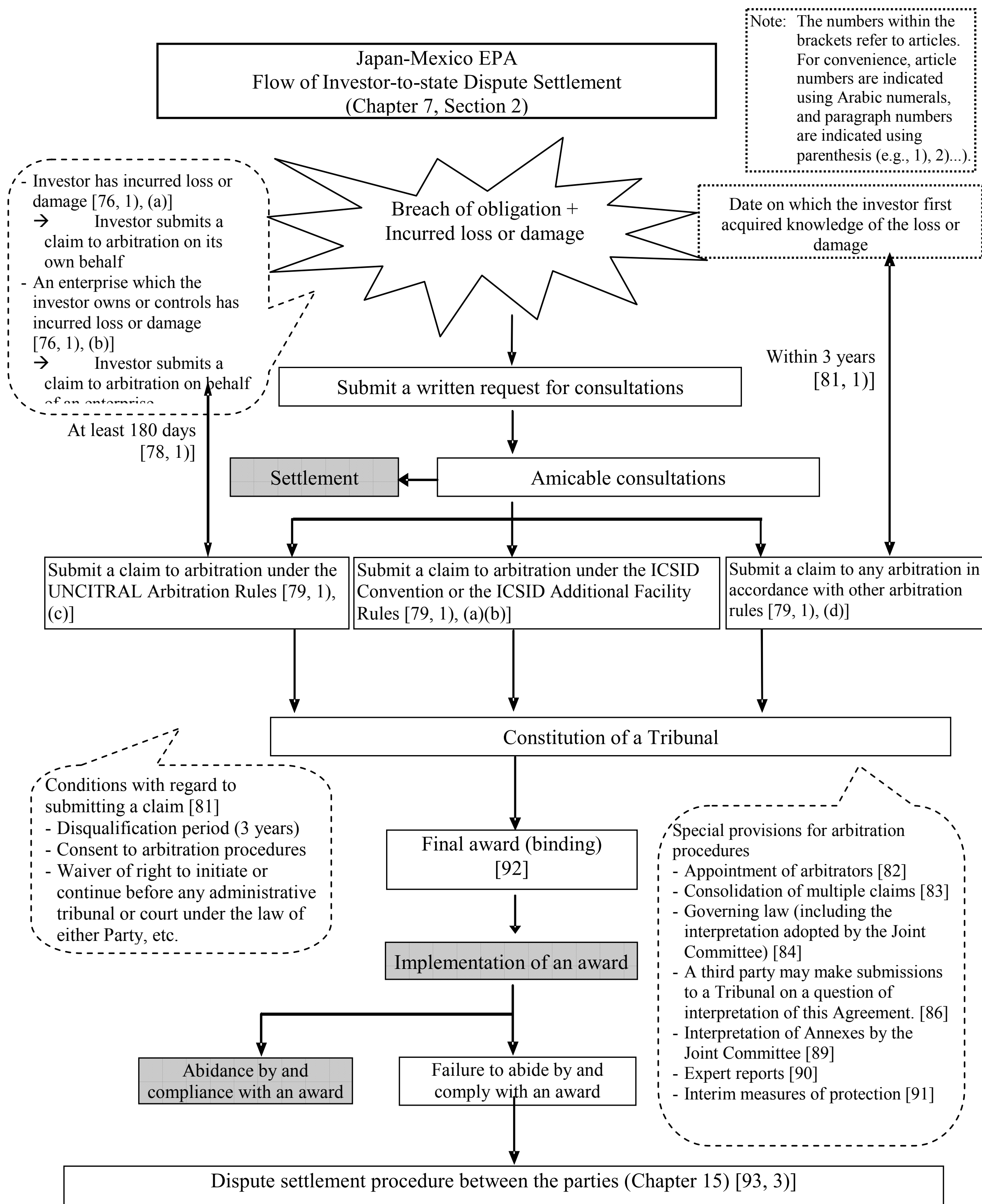
3) The Dispute Settlement Provisions for Investor-to-state Disputes which are provided in the Chapter regarding Investment in the EPA entered into by Japan (for the provisions related to "state-to-state" disputes, see Chapter 6).

All three EPAs entered into by Japan adopt the following common sequence of procedural steps: i) first, the parties to the dispute shall consult with each other with the view to resolving such dispute; ii) if the dispute is not resolved by consultation, either party may refer the case to an arbitration proceeding; and iii) pursuant to the award, if required, the defendant nation shall provide monetary compensation and/or restitution. While the foregoing procedural structure is, not only in common with the EPAs entered into by Japan, but also in common with the regional trade agreements which are executed between other countries, the specific text of the provisions differ depending on the agreements.

The following are the flowcharts of the dispute settlement procedures (investor-to-state) provided for in the "Japan-Singapore EPA," "Japan-Mexico EPA," and "Japan-Malaysia EPA," and for reference, the chapter regarding investment of NAFTA.



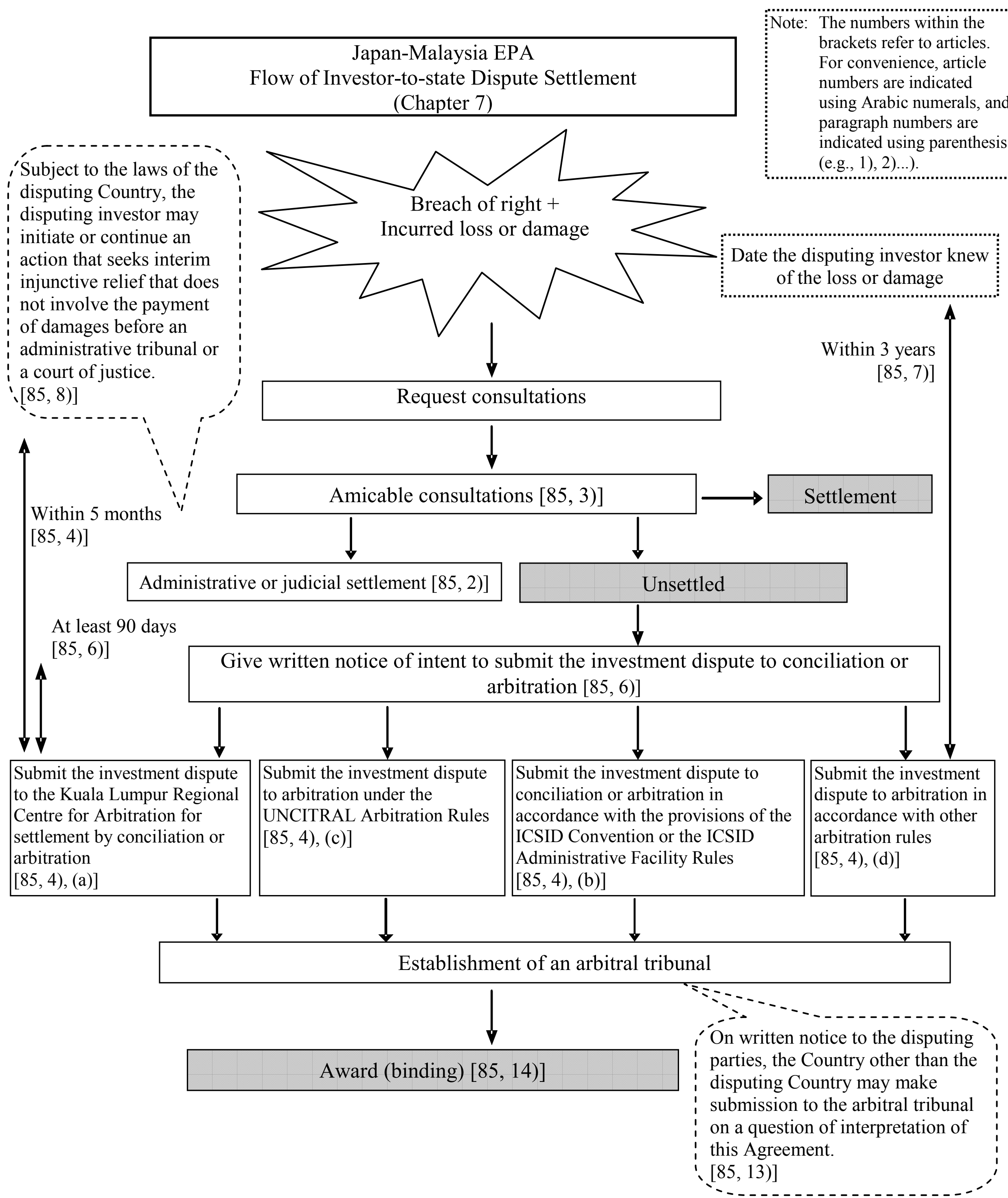
- Nothing in this Article shall be construed so as to prevent an investor to an investment dispute from seeking administrative or judicial settlement within the territory of the Party that is a party to the investment dispute. [82, 11)]
- Either Party may give diplomatic protection, or bring an international claim, in respect of an investment dispute which one of its investors and the other Party shall have consented to submit or shall have submitted to arbitration, when such other Party shall have failed to abide by and comply with the award rendered in such dispute. [82, 12)]



If a disputing Party fails to abide by or comply with a final award, the Party whose investor was a party to the arbitration may have recourse to the dispute settlement procedure under Chapter 15. In this event, the requesting Party may seek:

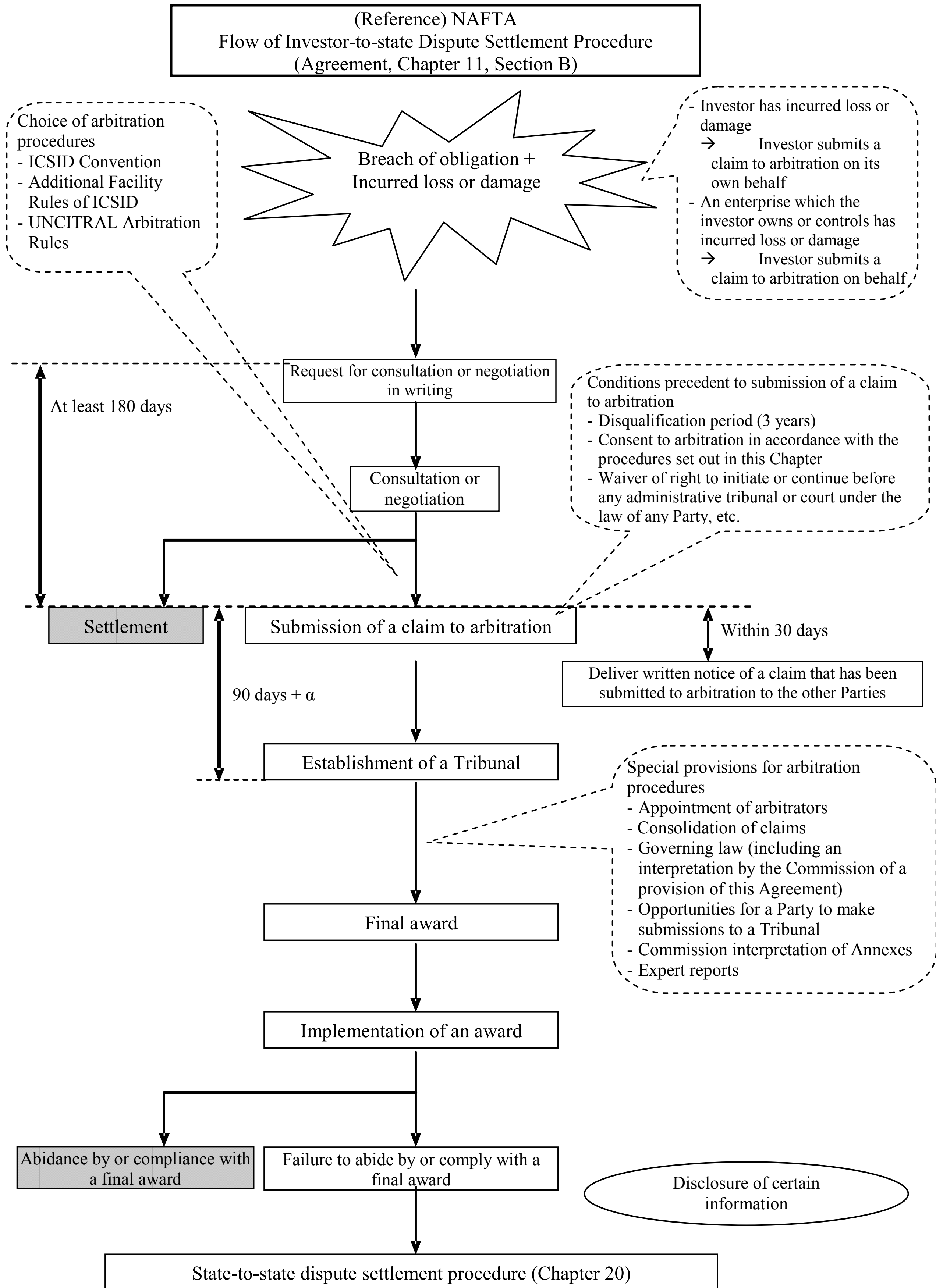
(a) a determination that the failure to abide by or comply with the final award is inconsistent with the obligations of this Agreement; and

(b) a recommendation that the Party abide by or comply with the final award. [93, 3)]



- Nothing in this Article (Settlement of Investment Disputes between a Country and an Investor of the Other Country) shall be construed so as to prevent a disputing investor from seeking administrative or judicial settlement within the disputing Country. [85, 2)]

- Either Country may, in respect of an investment dispute which one of its investors shall have submitted to arbitration, give diplomatic protection, or bring an international claim before another forum, when the other Country shall have failed to abide by and comply with the award rendered in such investment dispute. [85, 16)]


(Reference) NAFTA
Flow of Investor-to-state Dispute Settlement Procedure
(Agreement, Chapter 11, Section B)
Choice of arbitration procedures
- ICSID Convention
- Additional Facility Rules of ICSID
- UNCITRAL Arbitration Rules
Breach of obligation + Incurred loss or damage
- Investor has incurred loss or damage
→ Investor submits a claim to arbitration on its own behalf
- An enterprise which the investor owns or controls has incurred loss or damage
→ Investor submits a claim to arbitration on behalf
Request for consultation or negotiation in writing
At least 180 days
Conditions precedent to submission of a claim to arbitration
- Disqualification period (3 years)
- Consent to arbitration in accordance with the procedures set out in this Chapter
- Waiver of right to initiate or continue before any administrative tribunal or court under the law of any Party, etc.
Consultation or negotiation
Settlement
Submission of a claim to arbitration
Within 30 days
Deliver written notice of a claim that has been submitted to arbitration to the other Parties
90 days + α
Establishment of a Tribunal
Special provisions for arbitration procedures
- Appointment of arbitrators
- Consolidation of claims
- Governing law (including an interpretation by the Commission of a provision of this Agreement)
- Opportunities for a Party to make submissions to a Tribunal
- Commission interpretation of Annexes
- Expert reports
Final award
Implementation of an award
Abidance by or compliance with a final award
Failure to abide by or comply with a final award
Disclosure of certain information
State-to-state dispute settlement procedure (Chapter 20)

(Reference 1) Major Cases involving Investment Treaty Arbitration

Although not binding as a precedent, arbitral awards under investment agreements have a significant influence on subsequent arbitral awards. We will briefly summarize the leading cases of the investment treaty arbitration on the disputing issues which have been debated in investment arbitration. It should be noted that the awards summarized below are rendered based on the specific factual circumstances and the text of the relevant investment agreement, and therefore, their reasoning is not necessarily applicable to other cases.

1) Decisions on Jurisdiction

(a) Jurisdiction in Personam

(i) Tokios Tokelés v. Ukraine (ICSID Case No. ARB/02/18), [Decision on Jurisdiction], April 29, 2004

- Summary of the Decision

<u>"Investor" can include enterprises established in the home country and owned or controlled by nationals of the host country.</u>

Tokios Tokelés, a business enterprise established under the laws of Lithuania, owned a publishing company in Ukraine. Tokios Tokelés filed for arbitration, contending that because the Ukrainian publishing company held by Tokios Tokelés published a book that favorably portrayed a politician in the opposition party, Tokios Tokelés became subject to tax investigations from Ukrainian authorities that hindered its business activities, and that, for that reason, Ukraine breached the Ukraine-Lithuania BIT. The Ukrainian government claimed that because Tokios Tokelés was 99% owned and controlled by Ukrainians, it did not fall under the definition of an "investor" who was protected under such BIT. However, the arbitration tribunal held that because the BIT simply defined an "investor" as "any entity established in the territory of the Republic of Lithuania in conformity with its laws and regulations," Tokios Tokelés would also be deemed a Lithuanian "investor".

(b) Subject Matter Jurisdiction

(i) SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan (ICSID Case No. ARB/01/13), Decision of the Tribunal on Objections to Jurisdiction, August 6, 2003

- Summary of the Decision

a) <u>Even when the relevant investment contract has a clause that limits the jurisdiction over disputes regarding the contract to a separate tribunal, the arbitration tribunal under the BIT has jurisdiction over such disputes insofar as the claim is essentially based on a breach of the BIT.</u>

b) <u>The "umbrella clause" of the relevant BIT does not have the effect of characterizing a claim only based on a breach of investment contract as a breach of the obligations under the BIT, and the arbitral tribunal has no jurisdiction over a dispute regarding such breach of the investment contract.</u>

SGS, a Swiss company, entered into an agreement to provide pre-shipment inspection services to the government of Pakistan. Because the Pakistani government unduly reneged on the agreement after SGS had provided such services for a certain period, SGS requested arbitration claiming a breach

of the Switzerland-Pakistan BIT. The Pakistani government objected to the jurisdiction of the arbitral tribunal, claiming that the request of SGS pertained to the substance of the agreement and disputes regarding the agreement were required to be resolved by a separate process under the choice of forum clause.

The arbitral tribunal examined the umbrella clause provided for in the BIT, which is the clause providing that the State parties undertake to observe any contractual obligation they may have entered into with an investor of the other State party, in order to determine whether the clause, irrespective of a choice of forum clause in a State contract was intended to characterize a mere breach of such State contract as a breach of the BIT. The arbitral tribunal held in the negative due to a lack of clear evidence with respect to the BIT. As a result, the arbitral tribunal concluded that it had no jurisdiction.

(ii) SGS Société Générale de Surveillance S.A. v. Republic of the Philippines (ICSID Case No. ARB/02/6), [Decision of the Tribunal [on Objections to Jurisdiction]], January 29, 2004

- Summary of the Decision

<u>The arbitral tribunal established under the BIT has the authority to exercise jurisdiction over cases regarding a breach of contract.</u>

SGS Philippines entered into a contract to provide import cargo inspection services for the Philippines government. Subsequently, the Philippines government did not make payment pursuant to the agreement, and SGS, the Swiss parent company, requested arbitration on the grounds that such failure of payment constituted a breach of the Philippines-Switzerland BIT. The Philippines government claimed that the arbitration provisions of the BIT did not apply to disputes that were purely contractual, and further, the contract provided that domestic courts were to be used in any dispute regarding the contact.

Under the dispute settlement procedure clause of the BIT, the arbitral tribunal held that it had jurisdiction over disputes arising from contracts. In addition, the tribunal understood that the "umbrella" clause subjects disputes regarding the performance of contractual obligations to the protection provided in the BIT. However, the arbitral tribunal determined that it would not accept the admissibility of the case, and should not exercise its jurisdiction over the subject dispute, indicating that SGS entered into a contract with the Philippines government, agreeing to submit disputes concerning the contract only to domestic courts.

(c) Investments

(i) Fedax N.V. v. Republic of Venezuela (ICSID Case No. ARB/96/3), Decision on Tribunal [on Objection to Jurisdiction], July 11, 1997

- Summary of the Decision

<u>A promissory note constitutes "title to money" and therefore is an "investment" protected under an investment protection agreement.</u>

Fedax N.V., a Dutch enterprise, requested arbitration claiming payment was owed on promissory notes it owned, which were issued by the Venezuelan government. Venezuela, the respondent country, objected to the jurisdiction of the arbitral tribunal on the grounds that a promissory note did not constitute an "investment" as defined by the ICSID Convention and Netherlands-Venezuela BIT.

The arbitral tribunal held that an "investment" provided in such BIT included "every kind of asset, including titles to money." The arbitration tribunal further held that "titles to money" included loans and other credit facilities, and that a promissory note is by definition an instrument of credit.

Therefore, the arbitral tribunal held that the promissory notes were "investments" provided in the BIT or ICSID Convention.

(ii) Tokios Tokelés v. Ukraine (ICSID Case No. ARB/02/18), [Decision on Jurisdiction], April 29, 2004

- Summary of the Decision

The scope of "investments" covered by BITs is wide, and does not necessarily require cross-border transfer of capital.

See Item (a) above for the factual background. The Ukrainian government argued that the claimant had not shown that the source of capital that was used for its fundraising was non-Ukrainian, and therefore did not constitute an "investment" as defined in the foregoing BIT and ICSID Convention. The arbitral tribunal held that "the parties [to the ICSID Convention] have broad discretion to decide the kinds of investment they wish to bring to ICSID." In addition, it indicated that while the Ukraine-Lithuania BIT defined an investment as "every kind of asset invested by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter," the treaty contained no requirement that limited the scope of the "investment" depending on where the capital originated. It therefore concluded that as long as an enterprise established in accordance with the laws and regulations of Lithuania was making investments in Ukraine, the investment should be protected by such BIT.

2) Awards on Substantive Obligations

(a) National Treatment

(i) S.D. Myers, Inc. v. Government of Canada, [NAFTA] Arbitration under the UNCITRAL Arbitration Rules, Partial Award, November 13, 2000

- Summary of the Award

a) If a domestic investor and foreign investor are both in the same economic or business sector, then they are deemed to be in "like circumstances."
b) In finding a breach of the national treatment requirements in the governmental measure, a greater weight is given to the actual "impact" of the measure on the investment business rather than the "intent" of the government in introducing such measure,.

S.D. Myers, a U.S. company, was planning a business which involved establishing a subsidiary in Canada and treating in the U.S. the PCB waste obtained in Canada. There were competitors in Canada, but because the U.S. facility of S.D. Myers was located near the PCB waste, it had a cost advantage compared to its competitors. Although S.D. Myers had obtained import approval from the U.S. Environmental Protection Agency, it was unable to continue business due to PCB export prohibition measures of the Canadian government. It requested arbitration on the grounds that the export prohibition measures were in breach of the national treatment requirement under NAFTA, which reads "[e]ach Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors."

The arbitral tribunal agreed that the export prohibition constituted a breach of national treatment on the following ground. In interpreting "like circumstances," it referred to the OECD Declaration on International Investment and Multinational Enterprises, of which the U.S. and Canada were both members, and stated that whether the relevant foreign investor was in the same economic or business sector should be examined. In addition, it stated that "protectionist intent" was not necessarily decisive in whether there was anything against the discipline of national treatment, and

that practical impact such as creating a disproportionate benefit for nationals over foreign investors, etc., was significant. Canada claimed the purpose of the restriction was to maintain Canada's ability to process PCB within Canada. Although the arbitration tribunal found this purpose to be legitimate, it dismissed such claim on the grounds that there were legitimate alternative measures.

(ii) Pope & Talbot, Inc. v. The Government of Canada, Arbitration under the UNCITRAL Arbitration Rules, Award on the Merits [of Phase 2], April 10, 2001

- Summary of the Award

a) If a domestic investor and a foreign investor are both in the same economic or business sector, then they are deemed to be in "like circumstances."
b) A difference in treatment between domestic investors and foreign investors is justifiable if it is based on reasonable policy decisions and not intended to favor domestic investors.

Pope & Talbot, a U.S. company, established a subsidiary in Canada and was engaged in the manufacture and sale of softwood lumber. Most of its lumber was exported to the U.S. The company became subject to the export restrictions under the Canada-U.S.A. bilateral agreement. Such measures applied a complex regime of export quotas to duty-free exports permitted from certain states including the state in which Pope & Talbot's Canadian subsidiary was located, but did not impose any restrictions on exports from other states. Pope & Talbot claimed a breach of national treatment on the grounds that this export restriction was *de facto* disadvantageous treatment.

As mentioned above, NAFTA provides that the contracting party country accord to the investors of the other contracting party country treatment no less favorable than that it accords, "in like circumstances," to its own investors. In determining whether such foreign investor and domestic investor were in like circumstances, the arbitral tribunal considered that it was necessary to compare the foreign investor with the domestic investor in the same economic or business sector. In addition, even if there was any difference in treatment between the foreign investor and domestic investor, it could be justified if it was "shown that it is based on reasonable policy decisions and not intended to favor domestic investors over foreign investors." As a consequence, it held that the imposition of export restrictions on certain regions in order to prevent the application of countervailing duties by the U.S. was a reasonable policy decision, and that the domestic investor in the region to which the export restriction did not apply and Pope & Talbot were not in "like circumstances," and therefore there was no breach of national treatment.

(iii) Occidental Exploration and Production Company v. The Republic of Ecuador, London Court of International Arbitration, Case No. UN3467, Final Award, July 1, 2004

- Summary of the Award

In light of the objective of the national treatment provision, a domestic investor and foreign investor may be found to be in "like situations" even if they are not in the same business sector.

Occidental, a U.S. company, requested arbitration on the grounds that a denial of a refund of value-added tax provided under Ecuadorian tax law was in violation of the national treatment, under the U.S.A.-Ecuador BIT. The Ecuadorian government claimed that since Petroecuador, a domestic oil company, was also denied a refund of value-added tax, it was not discriminatory treatment against foreign investors.

The national treatment provision in the investment treaty provided that treatment not less favorable than domestic enterprises shall be accorded to foreign investors in "like situations." The arbitration tribunal stated that the objective of national treatment was to protect foreign investors compared to domestic vendors, and the determination of "like circumstances" could not be simply made by comparing their business sector in which certain business activities were being conducted. In

addition, it stated that while the concept of "like product" in GATT was considered to relate to competitive and substitutable products, "situation" can be interpreted to relate to all exporters that share such condition.

(b) Most-Favored Nation Treatment

(i) Emilio Augustín Maffezini v. The Kingdom of Spain, ICSID Case No. ARB/97/7, Decision on the Tribunal on Objections to Jurisdiction, January 25, 2000

- Summary of the Award

If the most-favored nation clause provides a wide scope of application, advantageous provisions regarding arbitration procedures stipulated in other BITs may be equally applied even when no specific reference is provided to such procedures, unless otherwise limited by public policy considerations.

After his investment in Spain failed, Maffezini, an Argentinean national, requested arbitration on the ground that the Spanish government was in violation of the Argentina-Spain BIT stating the business failure was due to acts and omissions of his partner in a joint venture which was a Spanish financial institution. The Spanish government objected to the jurisdiction of the arbitral tribunal on the grounds that the relevant BIT required that such dispute be referred to the domestic court of Spain before submitting it to arbitration, and that this procedural requirement had not been satisfied. Maffezini claimed that because the Spain-Chile BIT allowed submission of a case to arbitration without going through a domestic trial, he should be accorded the same right under the most-favored nation treatment of the Argentina-Spain BIT.

The arbitral tribunal noted that the most-favored nation treatment provision under the Argentina-Spain BIT is applicable to "all matters subject to this Agreement," and referred to the role of investment treaty arbitration in protecting investors, and concluded that the most-favored nation treatment provision applied to dispute settlement provisions as well. On the other hand, it stated that whether most-favored nation treatment would be extended to a matter was subject to limits arising from "public policy considerations" but that it did not apply to this case.

(ii) Plama Consortium Limited v. Republic of Bulgaria, ICSID Case No. ARB/03/24, Decision Jurisdiction, February 8, 2005

- Summary of the Award

In determining whether the entire arbitration procedures provided by other BITs apply by virtue of most-favored nation treatment, it requires demonstration of a clear and unambiguous agreement to that effect by the parties to the treaty providing the most-favored nation treatment.

Plama, a Cypriot company, requested arbitration on the grounds that an act of the Bulgarian government discriminating against the Bulgarian subsidiary was in breach of the Bulgaria-Cyprus BIT. The Bulgarian government objected to the jurisdiction of the arbitration tribunal on the grounds that in order to rely on the relevant BIT, a separate agreement of the party country submitting to arbitration was required. Plama claimed that based on the most-favored nation clause in the relevant BIT, the arbitration procedure contemplated under the Bulgaria-Finland BIT, i.e. ICSID arbitration, applied.

The arbitral tribunal found that there was no decisive evidence that the arbitration procedure was covered by the most-favored nation treatment in its text and context and in light of the object and purpose of the BIT. In addition, it referred to the negotiation process for revision of the Bulgaria-Cyprus BIT, and found that the party countries did not intend to apply most-favored nation treatment to arbitration procedures, and did not agree that the MFN provision of the Bulgaria-Cyprus BIT should

be interpreted to constitute the consent of Bulgaria to submit a dispute under the BIT to ICSID arbitration.

(c) Fair and Equitable Treatment

(i) CMS Gas Transmission Company v. The Argentine Republic, ICSID Case No. ARB/01/8, Award, May 12, 2005

- Summary of the Award

A stable legal and business environment is an essential element of fair and equitable treatment.

CMS, a U.S. company, obtained shares in an Argentinean privatized gas company (TGN). Upon the occurrence of an economic crisis in Argentina, the government did not maintain the tariff regime prescribed in the laws, regulations and license agreements, thus placing a burden on TGN's profit structure.

In response to CIT's claim regarding a breach of the BIT, the arbitral tribunal, stating that the government was not exempted from liability due to a state of emergency in this case, concluded that the government was in violation of the fair and equitable treatment obligation. In finding a breach of obligation, the arbitral tribunal, referring to the Preamble of the U.S.A.-Argentina BIT, stated that a stable legal and business environment is an essential element of fair and equitable treatment. In addition, it stated that such obligation provided in other BITs was inseparable from stability and predictability. Based on the foregoing, it held that by dismantling the tariff regime, the Argentinean government breached guarantees crucial for investment decisions, thereby breaching its obligation.

(ii) Eureko B.V. v. Republic of Poland, Ad Hoc Arbitration, Partial Award, August 19, 2005

- Summary of the Award

An act of the government which is arbitrary and driven by political motives is in breach of fair and equitable treatment.

Eureko, a Dutch company, entered into an agreement with the Polish government to purchase additional shares in PZU, a former state-owned insurance company of Poland, at the time of its public offering. By this additional purchase, Eureko was scheduled to own a majority of the shares of PZU. However, the government unilaterally changed plans, and at the time of the arbitral award, the shares of PZU had not yet been offered to the public. Eureko requested arbitration claiming that because privatization of PZU became a political issue, the Polish government purposefully took various actions which delayed PZU's IPO, in violation of the Netherlands-Poland BIT.

The arbitral tribunal referred to a statement of the State Treasury Minister, documents on resolution of the Council of Ministers, reports of the Poland's Supreme Audit Chamber, etc., and found that the government changed the PZU privatization plan based on the decision that the Ministry of Treasury needed to maintain control over PZU. It concluded that the measures of the country were in breach of fair and equitable treatment as such acts of the government were "for purely arbitrary reasons linked to interplay of Polish politics and nationalistic reasons of a discriminatory character."

(iii) Saluka Investments BV (The Netherlands) v. The Czech Republic, Arbitration under the UNCITRAL Arbitration Rules, Partial Award, March 17, 2006

- Summary of the Award

In order to comply with the fair and equitable treatment obligation, the government must (i) perform consistent, transparent, reasonable and non-discriminatory acts, and (ii) not frustrate the investor's reasonable expectations.

Saluka, a Dutch company (and a subsidiary of a Japanese company), held 46% of the shares of IPB, a former state-owned bank of the Czech Republic. IPB and three other state-owned banks dominated important positions in the financial market, but all had serious non-performing loan problems. The Czech government extended financial assistance to the three state-owned banks. Meanwhile, it did not extend any financial assistance to IPB, which was in a comparable situation with the three other state-owned banks, and did not substantially provide Saluka with an opportunity for negotiations with the government in accordance with Saluka's request. Because IPB's operations worsened, the government decided on forced administration, and IPB was subsequently transferred to another state-owned bank.

The arbitral tribunal stated in connection with the fair and equitable treatment obligation provided in the Netherlands-Czech BIT that a foreign investor is entitled to expect that the state will not act in a way that is manifestly inconsistent, non-transparent, unreasonable or discriminatory. Based on the foregoing, the arbitral tribunal indicated that the Czech government discriminated against IPB by unreasonably excluding it from financial assistance and negotiating in bad faith and in a non-transparent manner, and frustrated the legitimate and reasonable expectations of investors, and concluded that it was in violation of the fair and equitable treatment obligation.

* This is the only published case in which an enterprise with Japanese capital used BIT arbitration.

(d) Expropriation

(i) Pope & Talbot Inc. v. The Government of Canada, Arbitration under UNCITRAL, Interim Award, June 26, 2000

- Summary of the Award

In order to be deemed "expropriation," a substantial deprivation of property is required.

(See Item (a)(ii) above for factual background.) Pope & Talbot, a U.S. company, claimed that the quantitative export restrictions under the Softwood Lumber Agreement between the U.S. and Canada constituted expropriation. The arbitral tribunal decided that the intangible right of access to the U.S. market was also an "investment" protected under NAFTA. However, as to the issue of whether the export restriction constituted expropriation, it stated that there was no "substantial deprivation" because the claimant did not lose control of the company, and although income decreased due to a decrease in export volume, the business was continuing with a certain degree of income. It therefore concluded that the restriction did not constitute expropriation.

(ii) Metalclad Corp. v. United Mexican States, ICSID Case No. ARB(AF) /97/1, Award, August 30, 2000

- Summary of the Award

"[Measures tantamount to] expropriation" includes measures which have the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be expected economic benefit of property.

Metalclad, a U.S. company, acquired COTERIN, a company which obtained a hazardous waste landfill permit in a state in Mexico. Metalclad was informed by federal government officials that the only permit necessary for the construction and operation of the landfill was a federal permit,

and that the municipal government could not refuse granting the permit. However, after construction, the municipal government ordered the operation of the facilities to be stopped due to, among other things, Metalclad's lack of a permit from the municipal government. Metalclad could not operate and, thus requested arbitration claiming a breach of NAFTA.

The arbitral tribunal found that this measure was "tantamount to expropriation." In so finding, it held that "expropriation" included not only the open taking of property, but also any act which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property.

(iii) Técnicas Medioambientales Tecmed, S.A. v. United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, May 29, 2003

- Summary of the Award

In determining whether a governmental measure constitutes "expropriation," the impact on investment is a key element. At the same time, whether the government's measures are proportional to the public interest and to the protection legally granted to investments should be considered.

Tecmed, a Spanish company, was engaged in a hazardous landfill operation in Mexico, but was denied renewal of authorization to operate the landfill due to a violation of restrictions. Tecmed requested arbitration on the ground that such measure constituted expropriation within the meaning of the Spain-Mexico BIT.

The arbitral tribunal, referring to a declaration of the government and minutes of its meetings, found that the violation of the restrictions was acknowledged by the government to be minor, and that the true reason for denying the renewal of the permit was the opposition of the local residents. In determining whether the measure constituted expropriation, the arbitral tribunal stated that it required consideration of "whether such actions are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality." In particular, the arbitral tribunal examined whether denying the renewal because of a minor violation and opposition from local residents was proportionate but held in the negative, and found it constituted expropriation.

(Reference 2) Major Disputes by Industry

The foregoing summary of major cases is mainly focusing on legal issues. In contrast, this part will summarize, by industry sectors, arbitral awards, with a focus on the factual background and decisions regarding compensation. In cases referred to arbitration institutions such as ICSID or arbitration procedures under UNCITRAL rules, there are a variety of business sectors and governmental measures at issue. Here we will summarize some of the relatively new arbitral decisions regarding compensation.

- Import and Sale of Cement

Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt, ICSID Case No. ARB/99/6, Award, April 12, 2002

Middle East Cement Shipping and Handling Co. S.A., a Greek corporation, established a branch in Egypt and was engaging in the import and sale of cement. The license issued to the company by the Egyptian government authorized the importation, storage and transfer of cement for a period of 10 years. However, while the aforesaid license still had an effective period of just under four years, the Egyptian government imposed a total ban on imports of all kinds of portland cement.

Consequently, the license granted to the company was effectively revoked and the company was unable to continue business. In addition, the Egyptian government seized the ship owned by the company on the grounds that the company did not pay port dues, and sold the ship at auction. The company requested arbitration, claiming that the license agreement and the ship had been expropriated.

The arbitral tribunal recognized expropriation of the license agreement, and ordered compensation of lost profit taking into consideration expected sales contracts. It also found that the seizure of the ship constituted expropriation because it did not follow the due process of law by disregarding procedures such as a provision of proper notice, etc. The tribunal ordered the Egyptian government to pay compensation in the total amount of 2.19 million dollars.

- Television Broadcasting

CME Czech Republic B.V. v. The Czech Republic, UNCITRAL Arbitration Proceedings, Partial Award and Final Award, September 13, 2001 and March 14, 2003

CME, a Dutch company held by a U.S. entrepreneur, sought to obtain a license for television broadcasting in the Czech Republic jointly with a local company. The Media Council, which had the authority to grant licenses, under political pressure in connection with concerns over the acquisition of licenses by foreign investors, advised CME to change its business structure so CNTS, CME's local subsidiary, would not directly own a license. As a result, the broadcasting license was granted to CET21, a Czech company, and CNTS obtained the exclusive right to use the license, and was to operate a television station. At the time of granting the license, the Media Council approved this business structure, but subsequently changed its policy and exerted pressure by, for example, commencing procedures leading to the imposition of fines. Consequently, CTNS was effectively forced to agree to surrender its exclusive right to use the license, thus losing its legal basis for conducting business. CME requested arbitration on the grounds of expropriation and a breach of the fair and equitable treatment obligation under the Czech-Netherlands BIT.

The arbitral tribunal upheld the claim of the claimant, and ordered the Czech government to pay to CME the amount of approximately 270 million dollars (equivalent to the fair market value of the CNTS shares held by CME) plus interest.

* Lauder, a shareholder of CME, concurrently requested arbitration against the Czech Republic based on the U.S.-Czech BIT. The arbitral tribunal found a breach of the BIT in part in Lauder's claims, but dismissed the claim for compensation on the ground that there was no nexus between the violation and damage.

- Construction and Operation of Hazardous Waste Disposal Facilities

Técnicas Medioambientales Tecmed, S.A. v. United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, May 29 2003

Tecmed, a Spanish company, was successful in the bidding process of a state government in Mexico, and commenced hazardous landfill operations. Although the permit for the business was effective for five years, the company intended to operate for a longer period. The company requested arbitration on the grounds that the denial of a renewal of the permit was (i) equivalent to expropriation and (ii) in breach of fair and equitable treatment. The arbitral tribunal found that, among others, the true reason for denying the renewal of the permit was the opposition of the local citizens, and accepted the claim regarding expropriation (see above for details). In addition, the Tribunal indicated that the state government acted inconsistently by denying a renewal of the permit while having guaranteed to Tecmed that it would be able to continue business by relocating its site, and thus found a breach of fair and equitable treatment. As compensation, it ordered the Mexican government to pay to Tecmed

approximately 5.5 million dollars (equivalent to the market price of the landfill site at the time of the purchase plus subsequent additional investment and operating costs for two years) and interest. It also ordered Tecmed to take all the necessary steps to transfer, or cause to be transferred, the assets forming the landfill promptly after the effective and full payment by the Mexican government.

- Land Development

MTD Equity Sdn. Bhd. & MTD Chile S.A. v. Chile, ICSID Case No. ARB/01/7, Award, May 25 2004

MTD, a Malaysian company, planned to develop a district in the suburbs of Santiago, Chile, as a planned community. Based on the understanding that the zoning of the area would be changed, it obtained the approval of the Foreign Investment Commission on the investment project, and invested approximately 17 million dollars in the local subsidiary. After the investment, because the Ministry of Housing and Urban Development did not approve changes in zoning on the ground that it was against city planning policy, the project was forced to be suspended. MTD requested arbitration on the grounds that the rejection of changes in zoning after investment (i) was in breach of the fair and equitable treatment obligation and (ii) constituted expropriation under the Malaysia-Chile BIT.

The arbitral tribunal indicated that Chile engaged in inconsistent acts in connection with the project despite the existence of a cooperative mechanism among the governmental organizations under the legal system of Chile, and that it was an act which frustrated the expectations of the investor. It therefore found a breach of the fair and equitable treatment obligation. On the other hand, it also indicated that the claimant had performed inadequate due diligence in making its investment decisions, for example, by failing to examine the relevant regulations. As a result, it ordered Chile to pay to MTD a portion of the claim in the amount of approximately 5.8 dollars as compensation.

- Petroleum Industry

Occidental Exploration and Production Company v. The Republic of Ecuador, London Court of International Arbitration, Case No. UN3467, Final Award, July 1, 2004

Occidental, a U.S. company, entered into a service agreement for oil production with Petroecuador, a state-owned company of Ecuador. Ecuador's domestic law was amended to enable production-sharing agreements, and Occidental accordingly changed the type of the existing agreement with Petroecuador. After the replacement of the agreement, Occidental found it could no longer receive reimbursements of value-added tax, and requested arbitration on the grounds of a breach of the fair and equitable treatment obligation and the national treatment obligation under the U.S.-Ecuador BIT. The Ecuadorian government claimed that reimbursements of value-added tax were taken into consideration in the new agreement.

The arbitral tribunal, having examined the agreement and the relevant tax law, concluded that the agreement did not include reimbursements of value-added tax. In connection with the claim regarding a breach of the BIT, it pointed out a misinterpretation of the national tax authority and ambiguous tax changes, which, although not intentional, were a breach of the fair and equitable treatment obligation. As a result, it ordered the Ecuadorian government to reimburse value-added tax and compensate Occidental in the amount of 71.5 million dollars plus interest.

* The case is pending pursuant to the Ecuadorian government's request for annulment under the U.K. Arbitration Act.

- Gas Industry

Petrobart Limited v. Kyrgyz Republic, SCC Case No. 126/2003, Award, March 29, 2005

Petrobart, a company registered in Gibraltar, entered into a supply contract regarding gas condensate with KGM, a Kyrgyz government-affiliated company. As KGM had stopped payments during the term of the contract, Petrobart initiated domestic court proceedings in Kyrgyz. Petrobart acquired an enforceable court judgment requiring KGM's payment, and attempted to enforce it. However, as requested in a letter issued by the Vice Prime Minister, the enforcement was postponed. During this period of delay, the Kyrgyz government established a separate company and transferred to it only the assets of KGM. As a result, KGM went bankrupt, and Petrobart could no longer secure payment. Petrobart requested arbitration, claiming a breach of the fair and equitable treatment obligation under the Energy Charter Treaty.

The arbitral tribunal considered that, in light of the foregoing facts, Kyrgyz did not show due respect for the investor's rights, and therefore was in breach of the fair and equitable treatment obligation. With respect to compensation, the tribunal concluded that the claimant could have secured payment of 75% of the claimed amount had it not been for the transfer of assets, and ordered a payment to Petrobart equivalent to the amount of approximately 1.13 million dollars plus interest.

- Water Supply

Azurix v. Argentine Republic, ICSID Case No. ARB/01/12, Award, July 14, 2006

The state of Buenos Aires in Argentina conducted bidding for the privatization of water supply services, in which ABA, an Argentinean subsidiary of Azurix, was successful. After commencement of the services, the state did not perform obligations under the concession agreement such as the obligation to complete works on the water source necessary to maintain the quality of potable water, and refused to increase tariffs, thereby giving rise to a dispute between ABA and the state. As consultation between the parties failed, ABA applied for bankruptcy, and the state terminated the agreement because of an alleged breach of the agreement. Azurix requested arbitration on the grounds that the state's breach and termination of the agreement were (i) equivalent to expropriation and (ii) in breach of fair and equitable treatment.

The arbitral tribunal pointed out that the tariff regime permitted under the agreement was not appropriately applied for political reasons. Although the degradation in the quality of water was due to the state's default in the performance of its obligations, the state attributed it to ABA and induced the residents not to pay their bills. The tribunal thus supported the claimant's claim (ii) above. As compensation, it ordered payment to Azurix in the amount of approximately 165 million dollars as the fair market value of the concession terminated, taking into consideration the additional investment amount in ABA.

* The case is pending pursuant to the Argentinean government's request for annulment under Article 52 of the ICSID Convention.

- Construction and Operation of Airports

ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary, ICSID Case No. ARB/03/16, Award, October 2, 2006

ADC Affiliates, a Cypriot corporation (ultimately owned by a Canadian), and ADMC Management established a local corporation in Hungary, and such corporation and a Hungarian government organization entered into an agreement on expansion work and operation of the Budapest Airport. After completion of the work, the local corporation was operating the airport, but due to a policy change of the Hungarian government, the government made the agreement void and transferred the activities of the local corporation to a separate corporation designated by the government. As a result, the claimant could not receive dividends, management fees, etc. Because no compensation was

paid for this transfer, the claimant claimed that the government's action constituted expropriation, and requested arbitration based on the Cyprus-Hungary BIT.

The Hungarian government argued that the measure was justified because of the necessity to conform to EU laws, the claimant's breach of agreement, etc., but the arbitral tribunal did not accept the argument, and concluded that the measure constituted expropriation. As compensation, it ordered payment to the claimant in the amount of approximately 7.6 million dollars.