Chapter 5
INVESTMENT

(1) Background

1. Increase in Foreign Direct Investment

Since the 1980s, foreign direct investment has been growing rapidly worldwide, and, along with trade, continues to play a significant role in leading worldwide economic growth. In 1980, 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 2008, the figures had grown to 26.9% and 24.5% respectively (source: UNCTAD “World Investment Report 2009”).

With Japan’s balance of payments, which reflects the increases of securities investment and of direct investment, the income balance of FY2008 was approximately 14.6 trillion yen exceeding the trade balance of approximately 1.2 trillion yen; the fourth year in a row that the income balance exceeded the trade balance.

2. Trend in Execution of Bilateral Investment Treaties

In light of the growth of foreign direct investment, in order to protect investors and their assets from risks in the host country such as discriminatory treatment or sudden expropriation including nationalization, countries have executed many Bilateral Investment Treaties (BITs) since the 1960s. At the end of 2008, 2,676 BITs were in existence. Most of the agreements are in the form of “investment protection agreements,” which are applicable 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 “Recent developments in international investment agreements (2008-June.2009)”
3. Efforts at the OECD

With the acceleration of the expansion of foreign direct investment, new efforts were initiated to regulate the behavior of host countries in both the pre- and post-establishment phases. Specifically, efforts were made to reduce foreign capital restrictions on free cross-border investment. In 1995, negotiations on the Multilateral Agreement on Investment (MAI) commenced in the OECD. The member countries attempted to settle on a comprehensive and binding multilateral agreement regarding the liberalization and protection of investment. However, because of the concerns of NGOs and member countries that state regulatory authority, in particular environmental matters, would be harmed by the MAI, and France’s decision to withdraw completely the negotiations broke down in 1998. Thus, the MAI was not concluded.

Ever since its early days, the OECD has been tackling the task of formulating international agreements on investment. Although the Code of Liberalization of Capital Movements, enacted when OECD was established in 1961, provides for the liberalization of capital transactions except in certain cases, its enforceability is weak as it lacks dispute settlement provisions and only subjects each country to mutual examination (peer reviews). The Guidelines for Multinational Enterprises, drafted in 1976, state that governments of member countries would recommend that multinational enterprises behave responsibly, as their behavior may affect the development of the world economy. The guidelines have been 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. The revision in 2000 prescribed the establishment of National Contact Points to promote the Guidelines, handle enquiries on information, and help to resolve issues. It should be noted that, the guidelines themselves are not legally binding and their implementation is left to the discretion of each country and of each enterprise.

4. The Energy Charter Treaty (ECT)

The Energy Charter Treaty (ECT) is an example of efforts made in an individual sector. The treaty was drafted in order to protect energy-related trade, investments and transportation, particularly in the former Soviet block countries. The negotiation started at the initiative of European countries; was signed in 1994; and went into effect in 1998. The investment discipline is one of three pillars of the Energy Charter Treaty. Although limited to energy-related investments, it contains major investment rules. Japan signed the treaty in 1995 and ratified it in 2002. Each country of the former Soviet block continues to participate in the treaty following the collapse of the Soviet Union. The treaty was only provisionally applied to Russia, which did not ratify the treaty after signing it in 1994, but such provisional application was terminated upon notification made by the Russian Federation to the ECT secretariat on August 20, 2009. However, investments by ECT members during the period of the provisional application are to be protected for 20 years after the termination of the provisional application became effective.

5. Efforts at the WTO
At the WTO Singapore ministerial meeting in 1996, it was decided to consider whether investment should be included as an area for negotiation in the WTO framework, along with trade facilitation, transparency of governmental procurement and competition (the so-called “Singapore Issues”). Subsequently, discussions in the WTO on possible negotiations regarding “trade and investment” were made while the progress of discussions on the MAI at the OECD (which failed in 1998) was closely watched. It was agreed at the fourth ministerial meeting in 2001, which decided to start the Doha Development Agenda, to initiate negotiations if a clear consensus on negotiation modalities could be obtained at the fifth ministerial meeting. Starting in 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 establish rules regarding investments within the WTO framework, commencement of negotiations was not agreed upon at the fifth ministerial meeting held in Cancun, and investment was not included in the items to be negotiated in the Doha Development Agenda.

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 from legal and political risks including expropriation by the government of the developing country that receives the investments (also called the host country) or arbitrary operation of laws, thus securing proper treatment for 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. Most of the approximately 2,700 investment agreements currently existing in the world are “investment protection agreements.”

A new approach to investment agreements that emerged in the 1990s sought to address entry barriers to investment such as foreign capital restrictions in addition to providing post-establishment protection. Investment agreements reflecting this approach have entered into effect. They 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 included in a chapter on investment as part of FTAs/EPAs, and 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, there are two types of investment agreements: “investment protection agreements” and “investment protection/liberalization agreements.” The latter 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 and all elements mentioned hereunder are not necessarily included in all investment agreements.

(i) Definition of Investments and Investors

Investment agreements generally define, at the beginning, applicable investments and investors.

Regarding investments, a relatively broad definition is common, such as “all types of assets directly or indirectly owned or controlled by an investor.” The most important factors are companies and branches, such as local subsidiaries, to which investments are made. “Indirectly owned” refers to a relationship between a parent company and a second-tier subsidiary company where there is a line of capital ties, such as from a parent company to a subsidiary company and then to a second-tier subsidiary company, irrespective of whether such capital ties are established within a single country or via a third country. Investment agreements signed between the United States and South American countries inspired by the
former often specify [i] the contribution of assets and other resources, [ii] expectations for proceeds or profits, and [iii] the acceptance of risks, as three concrete requirements.

Regarding investors, they are often defined broadly as “persons who have the nationality of a contracting-party country under its laws and regulations” or “companies of a contracting-party country.” However, some agreements require that investors should “be conducting substantial business activities” or contain provisions that benefits under the agreements can be denied if an investor who does not conduct any substantial business activities is owned or controlled by a third-country company (denial rules).

Whether certain investors and their investments are protected under the investment agreements (i.e. whether an arbitral tribunal has the jurisdiction) is often contested in arbitration (refer to (Reference 1) 1) Decisions on Jurisdiction, (a) Jurisdiction in Personam and (b) Subject Matter Jurisdiction, below).

(ii) 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 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 only 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 Agreement, which has multiple Member countries, MFN treatment refers to providing equal treatment to goods and services of member countries, while in the case of a BIT it is to secure treatment equivalent to that which it provides to investors and the investments of any non-party that is given the most favorable treatment.

It is natural that MFN treatment extends the favorable treatment accorded to non-party countries by a contracting party country under ordinary investment treaties 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.

(iii) 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 investments. The objective of such provisions is for the host country to accord a certain level of treatment to investments. While NT and MFN treatment are obligations determined in relation to the treatment actually provided to other investors, fair and equitable treatment provides the level of treatment that should be accorded absolutely to everyone.

What specific treatment is deemed fair and equitable treatment, in specific instances, depends on the language or the context of the provision, the purpose of the agreement, and individual and specific circumstances. In practice, 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 and therefore can be interpreted as an autonomous standard.

Article 1105, paragraph 1 of NAFTA provides an obligation to accord fair and equitable treatment “in accordance with international law.” However, in *Pope & Talbot v. Government of Canada* 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 above the 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 by the United States. In response to criticism, the NAFTA Free Trade Commission 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. Subsequent arbitration cases have followed the Notes of Interpretation.

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, and the obligation not to frustrate the legitimate expectations of investors.

**(iv) Obligation to Observe the Commitment a Country Made to an Investor (Umbrella Clause)**

Taking into account that contracts concerning infrastructure products or resource development will be concluded between investors and the government of a host country, these provisions are intended to ensure that a host country performs the obligations it has assumed for individual investments based on such contracts. Referred to as the Umbrella Clause it is intended to comprehensively cover the responsibilities of investment contracts.

Breach of obligation in the investment contract automatically establishes a breach of the obligation in the treaty, and the method of dispute settlement in the treaty (including arbitration between investor and the state) becomes available in addition to the method of dispute settlement in the contract, which is an advantage for investors.

The Umbrella Clause has been included in many investment agreements, but recently there has been arbitration as to whether it covers all of the obligations in the contract.

**(v) 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 and technology transfer requirements, as conditions for investment and business activities of the investor in the other contracting party country. The WTO TRIMS Agreement 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 
“performance requirements.” This concept of prohibiting performance requirements is 
relatively new, and emerged in the discussion of MAI Agreement at the OECD. Ordinarily, it 
is not included in investment protection agreements but is included in “investment 
protection/liberalization agreements.”

Performance requirements are usually classified as one of two types: absolutely 
prohibited items; or items which are permitted if required as a condition for granting benefits. Under investment protection/liberalization agreements, local content requirement and export 
equity requirement, both of which are strictly prohibited in the TRIMS Agreement, are also 
strictly prohibited, with a view to maintaining consistency with the rules under the WTO 
Agreement. Items such as 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.

(vi) Approach to Liberalization Commitment

Approaches to liberalization commitments of NT, MFN and PR can be classified as one of 
two types: where NT, MFN and prohibition of PR are provided to all sectors except those 
which the contracting party countries list as exceptions (negative list approach); or where 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 exception for liberalization commitments is generally not 
included, except regarding matters related to nationalities of airplanes and ships. In 
“investment protection/liberalization agreements,” the U.S., Canada, and Singapore tend to 
adopt the negative list approach, which is highly transparent and legally stable (see e.g. the 
chapter on investment of NAFTA), and Southeast Asian 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 chapter on investment in Australia-
Thailand FTA, and “Schedule of India’s Commitments” in the chapter on investment in India-
Singapore CECA).

Two types of negative 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 lists with 
standstill and ratchet obligations: (1) measures inconsistent with the agreement cannot be 
newly introduced; (2) measures that do not conform to NT, MFN and PR obligations that 
existed 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 (3) once 
measures are revised to make them more consistent with the agreement, they cannot be made 
more inconsistent again (this is called as a “ratchet” obligation to indicate changes can only be 
made in one direction). Having the standstill obligation cover as many sectors as possible 
reduces risks to investors from changes of the legal system (i.e., domestic systems are made 
less favorable). At the same time, the contracting party countries can register especially 
sensitive sectors such as those relating to national security (arms and weapons industry; 
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 restrictions they 
consider necessary as well as securing legal stability in their foreign investment policies.
Part III Chapter 5 Investment

Specifically, the negative list adopted in the chapters on investment of NAFTA inscribes (i) the relevant sector (sub-sector); (ii) related obligations; (iii) legal grounds for the measure; and (iv) a summary of the measure, thereby helping ensure the transparency of the laws and regulations of the host country.
(vii) Expropriation and Compensation

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 date of expropriation should be made.

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 where environmental protection measures taken by a state government of Mexico allegedly constituted indirect expropriation; the Mexican government was held liable for breach of obligations under the agreement, infra at Dispute Settlement regarding Investment). Questions were raised concerning to what extent 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.-Australia FTA and U.S.-Chile FTA provide that indirect expropriations require a case-by-case inquiry. These FTAs require consideration of 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, non-discriminatory 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.

(viii) Protection from Strife

If investors have suffered loss or damage relating to their investments due to armed conflict, revolution, or civil disturbance, 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 investors or investors of a non-party. This is one of the fundamental investor protection provisions.

(ix) Subrogation

This provision recognizes the assignment to the contracting party country or its designated agency of investors’ claims arising in the event investments suffer damages. 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, 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. As for Japan, this applies to insurance and insurance contracts provided by Nippon Export and Investment Insurance and Japan Bank for International Cooperation.

(x) 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, thereby securing freedom of sending money from the contracting party country to the host country or sending profit gained in the host country to the contracting party country, aiming at a smooth business environment.

(xi) 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 first be made between the party countries, and if no settlement is reached by such consultation, the dispute will be submitted to an arbitral tribunal. Different from BITs, in FTAs/EPAs, it is stipulated that the provision of state-to-state dispute settlement pertains to the entire FTA/EPA, including the chapter on investment. This provision is provided in a section of the chapter on general provisions.

(xii) Investment Treaty Arbitration (Investor-to-state)
This provision provides that if any dispute arises between the investor and the host country and cannot be settled by consultation, investors may submit the investment dispute to arbitration in accordance with the arbitration rules of the International Centre for Settlement of Investment Disputes (ICSID) or ad hoc arbitration in accordance with the rules of the United Nations Commission on International Trade (UNCITRAL) (discussed later in “Dispute Settlement regarding Investment”). In FTAs/EPAs, it is provided in the chapter on investment.

(xiii) General Exceptions and Security Exceptions

It is provided that contracting party countries may take exceptional measures inconsistent with the agreement if doing so is necessary for maintaining public order, protecting life or health of people, as well as animals and plants, and defending such countries’ significant security interests. Arbitral tribunals have handled issues such as in what circumstances exceptional measures may be taken (for example, whether a government’s measures taken under an economic crisis fall under the category of exceptional measures). What is often controversial about this issue is the relationship between this provision and the principles of the state of necessity under customary international law (differences in the scope, requirements, legal nature, and the like).

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

As of March, 2010, Japan has signed or entered into 15 BITs and 9 EPAs with chapters on investment. This means that Japan has signed or entered into 24 investment agreements.

<table>
<thead>
<tr>
<th></th>
<th>Date Signed</th>
<th>Date Effected</th>
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<tbody>
<tr>
<td>(i)</td>
<td>Egypt</td>
<td>January 1977</td>
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<td>(ii)</td>
<td>Sri Lanka</td>
<td>March 1982</td>
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<td>(iii)</td>
<td>China</td>
<td>August 1988</td>
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<td>(iv)</td>
<td>Turkey</td>
<td>February 1992</td>
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<td>(v)</td>
<td>Hong Kong</td>
<td>May 1997</td>
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<td>(vi)</td>
<td>Pakistan</td>
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<td>(vii)</td>
<td>Bangladesh</td>
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<td>(viii)</td>
<td>Russia</td>
<td>November 1998</td>
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<td>(x)</td>
<td>Mongolia</td>
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<td>(xi)</td>
<td>South Korea</td>
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<td>(xii)</td>
<td>Vietnam</td>
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<td>(xiii)</td>
<td>Cambodia</td>
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<td>Uzbekistan</td>
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<td>*(i)</td>
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<td>*(xi)</td>
<td>Japan-Switzerland EPA</td>
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The 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

<table>
<thead>
<tr>
<th>Liberalization of Investment</th>
<th>Japan’s Previous Investment Protection Agreements</th>
<th>Japan-Singapore EPA (Chapter on Investment)</th>
<th>Japan-Korea Investment Agreement</th>
<th>Japan-Vietnam Investment Agreement</th>
<th>Japan-Mexico EPA (Chapter on Investment)</th>
<th>Japan-Malaysia EPA (Chapter on Investment)</th>
<th>Japan-Philippines EPA (Chapter on Investment)</th>
<th>Japan-Switzerland EPA (Chapter on Investment)</th>
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* = Absolutely prohibited, ● = Permitted if required as a condition for granting interest

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Part III Chapter 5 Investment
### Chart 5-4 Elements of Japan’s Investment Agreements (continue)

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* = Absolutely prohibited.
△ = Reserved at Annex.
○ = Excludes NT/PR.
× = Reconsultation.
△ (Excludes NT/PR) = Reserved at Annex.
Reconsultation.
(Excludes pre-establishment phase).
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4. Investment Agreements of Other Countries (including chapters on investment in FTAs/EPAs)

Chart 5-5 Elements of Investment Agreements of Other Countries

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### Part III Chapter 5 Investment

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### Part III Chapter 5 Investment

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<th>National Treatment after Investment</th>
<th>Most-Favored-Nation Treatment after Investment</th>
<th>Fair and Equitable Treatment</th>
<th>Umbrella Clause</th>
<th>Expropriation and Compensation</th>
<th>Protection from Strife</th>
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(Note 1) It is provided that a negative list shall be submitted to the ASEAN secretariat within six months after signing an agreement.

(Note 2) It is provided that discussions on a negative list, MFN, and prohibition of PR in addition to the TRIMS are to be completed within five years after an agreement becomes effective. NT, MFN, and prohibition of officers’ nationality requirement shall not be applied until a negative list is prepared. The TRIMS shall be applied upon the effectuation of an agreement except for the case of Laos. (Article 27)
Utilization of Investment Agreement Arbitration

It is said that investment agreement arbitration lasts two to four years on average and requires tens of millions to hundreds of millions of yen. Therefore, whether or not to apply for arbitration of a dispute is determined by taking such cost-effectiveness into consideration. Consequently, what are to be submitted to arbitration are often cases involving a massive amount of investment, such as those concerning infrastructure development or resource development. In many cases, instead of actually submitting a case to arbitration, that possibility is frequently used as leverage to favorably advance a negotiation toward reconciliation. The “Saluka” case is the only publicized case where a Japanese company resorted to investment agreement arbitration (see References 1, 2) Awards on Substantive Obligations, (c) Fair and Equitable Treatment, (iii) Saluka Investments BV (The Netherlands) v. The Czech Republic, Arbitration under the UNCITRAL Arbitration Rules, Partial Award, March 17, 2006). Otherwise, some companies choose to make investments via a company in a third country, considering whether or not there are any applicable investment agreements, in addition to any preferential tax treatments.

Comparing the characteristics of arbitration under the ICSID Convention and ad hoc arbitration in accordance with the rules of the UNCITRAL, the former is rather convenient, as ICSID arbitral tribunals are established under the World Bank, with its high-availability of meeting rooms and lists of arbitrator candidates, as well as clearly defined standard charges (for example, the registration fee for ICSID arbitration submission is 25,000 dollars, the operation fee after commencing arbitration is 20,000 dollars, compensation per arbitrator is 3,000 dollars a day, and the like). However, as the submission of a dispute and the outline of the arbitration award are to be publicized unless related parties reach an agreement, this system is not appropriate when they want to carry out the procedures in a manner completely closed to the public. If the government of the host country refuses to enforce the arbitration award, it may face the suspension of World Bank loans, so the arbitration award has been enforced in almost all cases.

In the case of ad hoc arbitration in accordance with the rules of the UNCITRAL, domestic courts of the place of arbitration are supposed to intervene, as in the case of ordinary commercial arbitration, and the selection of arbitrators can be more flexible. Costs may be higher or lower than in the case of ICSID arbitration, depending on how procedures actually progress. While the ICSID arbitration process is managed to some extent by the ICSID secretariat and meeting rooms are provided by the ICSID, UNCITRAL ad hoc arbitration sometimes proceeds without a permanent secretariat and is apt to take longer and cost more. How to share arbitration costs among related parties (investors and the government of a host country) is to be determined by an arbitral tribunal unless the parties reach a special agreement. There has been a case where the losing party was made to bear all the costs.

Solution through Means Other than Investment Agreement Arbitration

As described in the above column, investment agreement arbitration requires considerable costs and time, and many companies hesitate to utilize the system. Furthermore, when intending to continue business in the country, the parties concerned have to consider the
possibility that the arbitration proceeding may lead to worsened relations with the government of the host country and that media reports may cause negative effects on other fields of their business. Therefore, solutions regarding any breach of chapters on investment in EPAs or bilateral investment agreements are not always limited to arbitration. Firstly, in some cases, reconciliation can be reached with the government of a host country prior to arbitration. Generally, negotiations are often held in the presence of lawyers around the time when a company presents a notice of intent to the government of the host country prior to submitting a dispute for ICSID arbitration or other forms of arbitration. Specific cases are rarely made public, but at the end of last year, the media reported that U.S. energy companies and Ecuador agreed on a settlement of nearly 80 million dollars. As conventional means, respective governments of investors’ countries have diplomatically protected companies when their interests are infringed unjustly, not only in the case of infringement under chapters on investment in EPAs or investment agreements. If there are such chapters or agreements, governments can exercise diplomatic protection in a more effective manner based on clear criteria.

Furthermore, EPAs that Japan has concluded recently often contain provisions to establish a subcommittee on the improvement of the business environment, preparing a framework for companies to have discussions toward the improvement of the business environment in a host country prior to the occurrence of any dispute, apart from the case of investment agreement arbitration (refer to Part III, Chapter 8 “Improvement of Business Environment” for details). A subcommittee brings together not only the government of a host country but also other related parties from local industries; the government of an investing country, JETRO and other organizations in charge of matters that will be consulted; and issues that are difficult for a single company to raise and those related to the overall industry or an investing company as a whole are discussed collectively. Matters to be consulted are not limited to those concerning chapters on investment, but cover a wide range of business-related issues, such as the development of industrial infrastructure, the simplification and enhancement of transparency in administrative procedures, and the protection of intellectual property. The government of a host country is required to take appropriate measures in response to a request made via a subcommittee based on the provisions of an EPA and other agreements. As of now, such subcommittees on the improvement of the business environment have convened meetings based on EPAs with Thailand, Malaysia, Mexico and Chile. Under the Japan-Peru Investment Agreement, a “subcommittee on the improvement of investment environment” is to be established with a view to exchanging information or having discussions concerning matters that are related to investment within the scope covered by the agreement and are linked to the improvement of the investment environment. Furthermore, the “Japan-Brazil Joint Committee on Promoting Trade and Investment” was established with related parties in Brazil in July 2008 as a framework not based on an intergovernmental agreement.
Dispute Settlement Regarding Investment

1. Background 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 highly developed WTO dispute settlement procedures (formerly GATT dispute settlement procedures) already exist with respect to “state-to-state” dispute settlement, covering a wide scope of disputes regarding trade and investment, it is rare that such procedures are used under FTAs/EPAs and BITs.

On the other hand, most FTAs/EPAs and BITs provide “investor-to-state (host country)” dispute settlement procedures for investment cases, under which the investor may submit a dispute to arbitration with the host country when the investor suffers 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. By these procedures, investors can limit damages to their business through prompt collection of invested funds, and the procedures are considered a resolution that is responsive to the needs of investors.

In addition, if investment agreements or individual concession agreements do not have any special arrangements for dispute resolution between investors and the host country, investors normally have no recourse but to file a dispute with the host country in its domestic court. 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. Therefore, the “investor-to-state” dispute settlement provisions in many FTAs/EPAs and BITs provide a prior consent of the contracting party countries to submit disputes to arbitration (in the form of an unconditional prior consent on arbitration submission), in order to enable investors to submit such investment disputes to arbitration immediately without having to obtain 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 Procedures

Countries began to enter into BITs in the 1960s. At that time, BITs generally 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 proceeding would damage relations with the host country, the number of arbitration cases submitted by investors initially remained at a 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
multilateral investment agreement negotiations at the OECD in 1995. Both contributed to an increased interest in the use of treaty-based investment arbitrations. As a result, the number of cases submitted to arbitral tribunals drastically increased from the late 1990s.

**Chart 5-6 Trend of Referral to Arbitration (1987-2008)**

![Chart 5-6 Trend of Referral to Arbitration (1987-2008)](source)

The primary arbitration procedures designated in 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. More than sixty percent of past arbitration cases were submitted to ICSID.

**Chart 5-7 Percentage of Cases Submitted to Major Arbitration Procedures (until 2008, 317 cases in total)**

![Chart 5-7 Percentage of Cases Submitted to Major Arbitration Procedures (until 2008, 317 cases in total)](source)

(iii) Countries involved in Arbitration Cases
According to the summary prepared by UNCTAD, the country which was the “respondent” most frequently in “investor-to-state” dispute cases submitted in the past, was Argentina (48 cases), followed by Mexico (18 cases), the Czech Republic (15 cases) and the Ecuador (14 cases). A significant number of cases filed against Argentina were due to the political disruption relating to 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. The reason Mexico and the U.S. are respondents in many cases is assumed to be because cases based on Chapter 11 of NAFTA have attracted considerable attention and that investors became aware of the effect of such cases.

Chart 5-8 Number of claims, by defendants
(as of December 2008)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Number of Cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Argentina</td>
<td>48</td>
</tr>
<tr>
<td>2</td>
<td>Mexico</td>
<td>18</td>
</tr>
<tr>
<td>3</td>
<td>Czech Republic</td>
<td>15</td>
</tr>
<tr>
<td>4</td>
<td>Ecuador</td>
<td>14</td>
</tr>
<tr>
<td>5</td>
<td>Canada</td>
<td>13</td>
</tr>
<tr>
<td>6</td>
<td>United States of America</td>
<td>12</td>
</tr>
<tr>
<td>7</td>
<td>Ukraine</td>
<td>11</td>
</tr>
<tr>
<td>8</td>
<td>Poland</td>
<td>10</td>
</tr>
<tr>
<td>9</td>
<td>Egypt</td>
<td>9</td>
</tr>
<tr>
<td>9</td>
<td>India</td>
<td>9</td>
</tr>
<tr>
<td>9</td>
<td>Venezuela</td>
<td>9</td>
</tr>
<tr>
<td>12</td>
<td>Russian Federation</td>
<td>8</td>
</tr>
<tr>
<td>13</td>
<td>Romania</td>
<td>7</td>
</tr>
<tr>
<td>13</td>
<td>Turkey</td>
<td>7</td>
</tr>
<tr>
<td>15</td>
<td>Georgia</td>
<td>6</td>
</tr>
<tr>
<td>15</td>
<td>Kazakhstan</td>
<td>6</td>
</tr>
<tr>
<td>17</td>
<td>Hungary</td>
<td>5</td>
</tr>
<tr>
<td>17</td>
<td>Moldova</td>
<td>5</td>
</tr>
<tr>
<td>19</td>
<td>Bolivia</td>
<td>4</td>
</tr>
</tbody>
</table>

(Source: Reference of UNCTAD)

(iii) Status of Use of Arbitration Procedures by Enterprises

According to the summary prepared by UNCTAD, the industry sector using arbitration procedures most frequently is the tertiary sector of industry (i.e., electrical power, communications, securities, water supplies, waste management) at 39%, followed by secondary industry at 31% and primary industry at 24%.

The past cases involving primary industry all pertain to the mining industry and petroleum and gas excavation. 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 below in “Reference 2.”)

3. Overview of Legal Disciplines

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 older BITs broadly define the subject disputes as “any legal dispute that may arise out of investment made by an investor of either Contracting Party” (e.g., 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 (e.g., 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 (where both the home country of the investor and the disputing party country are ICSID member countries), ICSID Additional Facility Rules (where 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 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 an arbitration body and rules, an arbitral tribunal is selected. The arbitration is then conducted in accordance with the rules of individual arbitration procedures selected by investors. However, the relevant agreement may add amendments regarding the selection method of the arbitrator, information disclosure, consolidation of claims, and provision of opportunity for third parties to state opinions (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 that 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. 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).

(viii) Enforcement of Awards

The text of the ICSID Convention, rather than its Arbitration Rules, provides for the enforcement of awards (Articles 53-55). Most awards are implemented voluntarily. In cases based on arbitration other than the ICSID Convention, awards may be enforceable pursuant to the domestic laws of the Contracting States, according to the New York Convention.

4. Summary of Major Arbitral Bodies and Arbitration Rules

<table>
<thead>
<tr>
<th>Legal Foundation</th>
<th>ICSID Convention (the “Convention”) and the Arbitration Rules (the “Rules”)</th>
<th>ICSID Additional Facility Rules</th>
</tr>
</thead>
<tbody>
<tr>
<td>- 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.).</td>
<td>- 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.</td>
<td></td>
</tr>
</tbody>
</table>
- The ICSID Convention came into force in 1966. There were 155 Contracting States as of 2007.
- The ICSID Convention (totaling 75 Articles) provides for arbitration in Articles 36-55.
- The “Arbitration Rules” provide the details regarding arbitration proceedings.

**Subject Matter**
- Disputes regarding investments between the nationals of a Contracting State and other Contracting States. (Convention, Article 1, (2))
- 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 them 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. (Convention, 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 the arbitrators (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)
<table>
<thead>
<tr>
<th>Tribunal Proceedings</th>
<th>Award</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Arbitration proceedings shall be held at the seat of the Centre, in principle.  (Convention, Article 62, Rules, Rule 13)</td>
<td>- 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)</td>
</tr>
<tr>
<td>- 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))</td>
<td>- The place of arbitration shall be determined by the Arbitral Tribunal. (Schedule C, Article 20)</td>
</tr>
<tr>
<td>- The parties are not allowed to institute in a court of the States an objection contrary to the award. (Convention, Article 53, (1))</td>
<td>- 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)</td>
</tr>
<tr>
<td>- 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)</td>
<td>- Provisional measures for the preservation of rights may be ordered or recommended. (Schedule C, Article 46)</td>
</tr>
<tr>
<td>- Provisional measures for the preservation of its rights may be recommended by the Tribunal. (Rules, Rule 39)</td>
<td>- 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)</td>
</tr>
<tr>
<td>- 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)</td>
<td>- Shall be made by a majority of the votes of all its members. (Schedule C, Article 24)</td>
</tr>
<tr>
<td></td>
<td>- The award shall be binding on the parties. (Convention, Article 53)</td>
</tr>
<tr>
<td></td>
<td>- In certain circumstances, either party may request revision or annulment of the award. (Convention, Articles 51 and 52)</td>
</tr>
<tr>
<td></td>
<td>- The award shall be final and binding on the parties. (Schedule C, Article 52, (4))</td>
</tr>
</tbody>
</table>
### UNCITRAL Arbitration Rules vs. ICC Rules of Arbitration

<table>
<thead>
<tr>
<th>Authorizing Law, etc.</th>
<th>UNCITRAL Arbitration Rules</th>
<th>ICC Rules of Arbitration</th>
</tr>
</thead>
<tbody>
<tr>
<td>- The United Nations Commission on International Trade Law (UNCITRAL) was established by the General Assembly in 1996. It is located in Austria (Vienna).</td>
<td>- The International Chamber of Commerce (ICC) was founded in 1923. It is located in France (Paris).</td>
<td></td>
</tr>
<tr>
<td>- UNCITRAL itself is an organization which provides rules; it does not conduct arbitration proceedings.</td>
<td>- Currently, 7,400 companies and associations from 130 countries have joined as members.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Subject Matter</th>
<th>Disputes arising in the context of international commercial relations, such as commercial contracts, etc. (Resolution)</th>
<th>Business disputes of an international character. (Article 1)</th>
</tr>
</thead>
</table>

| 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) |

<table>
<thead>
<tr>
<th>Appointment of Arbitrators</th>
<th>- Three arbitrators, in principle. (Article 5)</th>
<th>- A sole arbitrator, in principle. (Article 8.2)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>- 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)</td>
<td>- 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.</td>
</tr>
<tr>
<td></td>
<td>- 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)</td>
<td>- Where the dispute is to be referred to three arbitrators, each party shall nominate one arbitrator for the ICC’s confirmation. The third arbitrator shall be appointed by the ICC, in principle.</td>
</tr>
<tr>
<td></td>
<td>- 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)</td>
<td>- Where a party fails to nominate an arbitrator, the appointment shall be made by the ICC. (Articles 8.3 and 8.4)</td>
</tr>
<tr>
<td></td>
<td>- 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)</td>
<td>- Every arbitrator must be and remain independent of the parties involved in the arbitration. (Article 7.1)</td>
</tr>
<tr>
<td></td>
<td>- Arbitrators are obligated to disclose any facts or circumstances which might be of such a nature as to call into</td>
<td></td>
</tr>
<tr>
<td>Tribunal Proceedings</td>
<td>- The place of arbitration shall be determined by the arbitral tribunal if the parties have not agreed upon it. (Article 16.1)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- The place of arbitral proceedings shall be determined at the arbitral tribunal’s discretion. (Articles 16.2 and 16.3)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- The arbitral tribunal shall have the power to rule on objections that it has no jurisdiction. (Article 21.1)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- The language to be used in the proceedings shall be determined by the arbitral tribunal if the parties have not agreed upon a language. (Article 17.1)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- If the parties have failed to designate the applicable law, the arbitral tribunal shall determine that which it considers applicable. (Article 33.1)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- The arbitral tribunal may take any interim measures. (Article 26.1)</td>
<td></td>
</tr>
<tr>
<td>Award</td>
<td>- Shall be made by a majority of the arbitrators. (Article 31.1)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- The award shall be final and binding on the parties. (Article 32.2)</td>
<td></td>
</tr>
<tr>
<td>Arbitration Rules of the SCC Institute</td>
<td>- An Award is made 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)</td>
<td></td>
</tr>
<tr>
<td>Authorizing Law, etc.</td>
<td>- The award shall be binding on the parties (Article 28.6)</td>
<td></td>
</tr>
</tbody>
</table>
### Part III Chapter 5 Investment

<table>
<thead>
<tr>
<th>Subject Matter</th>
<th>Chamber of Commerce came into force on January 1, 2007.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commencement of Arbitration Proceedings</td>
<td>Arbitration is initiated by the Claimant filing a Request for Arbitration with the SCC Institute. (Article 2)</td>
</tr>
<tr>
<td>Appointment of Arbitrators</td>
<td>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)</td>
</tr>
</tbody>
</table>

- 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 and 14.3)

<table>
<thead>
<tr>
<th>Tribunal Proceedings</th>
<th>Unless agreed upon by the parties, the Board shall decide the seat of arbitration. (Article 20.1)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The Arbitral Tribunal may conduct hearings at any place which it considers appropriate. (Article 20.2)</td>
</tr>
<tr>
<td></td>
<td>Unless agreed upon by the parties, the Arbitral Tribunal shall determine the</td>
</tr>
</tbody>
</table>
Part III Chapter 5 Investment

- 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)

5. The Dispute Settlement Provisions for Investor-to-state Disputes which are provided in the Chapter regarding Investment in the EPAs entered into by Japan (see Chapter 7 for the provisions related to “state-to-state” disputes,).

Most of the 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 the 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. While the foregoing procedural structure is used not only in common with the EPAs entered into by Japan, but also in common with the regional trade agreements 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.
Part III Chapter 5 Investment

Flow of Investor-to-state Dispute Settlement

Note: The numbers within the brackets refer to articles. For convenience, article numbers are indicated using Arabic numerals, and paragraph numbers are indicated using parenthesis (e.g., 1), 2)...

Japan-Singapore EPA

Breaches of right & Incurred loss or damage

Request consultations

Amicable consultations

Settlement

Administrative or judicial settlement

Unsettled

Agreed dispute settlement procedures

An investor shall give to the Party a written notice of intent to submit an investment dispute

Request the establishment of an arbitral tribunal in accordance with the procedures set out in Annex V C

Submit the investment dispute to arbitration under the Arbitration Rules of UNCITRAL

Submit the investment dispute to conciliation or arbitration in accordance with the provisions of the ICSID Convention or the Additional Facility Rules of ICSID

Establishment of conciliation/Arbitral tribunal

The award shall include:
(i) a judgment whether or not there has been a breach by the Party of any rights; and
(ii) a remedy if there has been such breach.
Remedies are pecuniary compensation; restitution; or a combination of (i) and (ii).

Award

Award under

Award not under

Settlement

The Party notifies the investor that it will implement the award

Unable to agree as to the amount of pecuniary compensation within 60 days after the date of the award

Refer to the arbitral tribunal

Final award (binding)

Agree/decide as to the amount of pecuniary compensation

Implementation of an award

Settlement

Conditions with regard to submitting the investment dispute to ICSID arbitration:
- Allowed to indicate up to 3 nationalities of arbitrators which are unacceptable.
- Any person whose nationality is excluded shall not be appointed.

Within 5 months

[82, 3]

At least 90 days

[82, 8]

Within 30 days

[82, 10), (c), (A)]

Date on which the investor knew of the loss or damage

Less than 3 years

[82, 4), (a)]

Note:
- Nothing in this Article shall be construed 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]
Part III Chapter 5 Investment

Japan-Mexico EPA
Flow of Investor-to-State Dispute Settlement (Chapter 7, Section 2)

Investor has incurred loss or damage [76, 1], (a)]
- Investor submits a claim to arbitration on its own behalf
- An enterprise which the investor owns or controls has incurred loss or damage [76, 1], (b)]
- Investor submits a claim to arbitration on behalf

At least 180 days [78, 1]

Submit a written request for consultations

Settlement

Amicable consultations

Constitution of a Tribunal

Submit a claim to arbitration under the UNCITRAL Arbitration Rules [79, 1], (c)]
Submit a claim to arbitration under the ICSID Convention or the ICSID Additional Facility Rules [79, 1], (a)(b)]
Submit a claim to any arbitration in accordance with other arbitration rules [79, 1], (d)]

Final award (binding) [92]

Implementation of an award

Abidance by and compliance with an award

Failure to abide by and comply with an award

Dispute settlement procedure between the parties (Chapter 15) [93, 3]

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 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]
Part III Chapter 5 Investment

(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

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.

Delivery written notice of a claim that has been submitted to arbitration to the other Parties

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

Disclosure of certain information

State-to-State dispute settlement procedure (Chapter 20)

90 days + α

Within 30 days

Establishment of a Tribunal

Final award

Implementation of an award

Abidance by or compliance with a final award

Failure to abide by or comply with a final award

At least 180 days

Settlement

Request for consultation or negotiation in writing

Consultation or negotiation
(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 principal issues which have been debated in the leading investment treaty arbitration cases. In general, claims over jurisdiction are raised quite often before arbitral tribunals. Where it is determined that the arbitral tribunal has jurisdiction, a decision on the merits of the case is made thereafter. The decisions on jurisdiction and the substance of the case are given either separately or together as one decision. Regarding decisions on the merits of the case, decisions on breach of obligation and on compensation are given either separately or together. As shown by the fact that many cases reach an amiable settlement after the jurisdiction of the arbitral tribunal is held in the affirmative, the determination of jurisdiction has a great influence on the negotiation between investor and state.

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

“Investor” can include enterprises established in the home country and owned or controlled by nationals of the host country.

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 in which Tokios Tokelés had invested published a book that favorably portrayed a politician in the opposition party, Tokios Tokelés became subject to tax investigations by 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.

The arbitral tribunal held that the nationality of a company is determined not based on the provisions of Article 25(2)(b) of the ICSID Convention but by the respective BIT. Consequently, it rendered a decision that Tokios Tokelés would be deemed to be a Lithuanian investor, as the BIT only defines an investor to be “any entity established in conformity with the laws and regulations in the Republic of Lithuania.”

* (For the decision concerning investments, refer to 1) (d) (iii) below.)

(ii) The Rompetrol Group N.V. v. Romania (ICSID Case No. ARB/06/3), [Decision on Jurisdiction and Preliminary Objections], April 18, 2008

Summary of the Decision

a) “Investor” under the ICSID Convention shall be determined based on the definition under the BIT.
b) “Investor” under the relevant BIT includes a corporation that is established in a home country, and owned and controlled by citizens of a host country.

Rompetrol Group, a Dutch company, acquired the majority of shares of Petromidia, an oil refinery, from the Romanian privatization authority and renamed it as Rompetrol Rafinare S.A. (RRC). Later, RRC was investigated by the Romanian prosecutors with regard to this transaction. The claimant filed a request for arbitration, alleging that such investigations breach the Netherlands-Romania BIT. The Romanian government objected to the jurisdiction of the arbitral tribunal on the grounds that the claimant is solely or mainly controlled by individuals who have Romanian nationality and reside in Romania, and its funds have originated in Romania.

The arbitral tribunal understood that a State determines the citizenship of its nationals by its law, and that “nationals” of a contracting party as “investors” under Article 25(2)(b) of the ICSID Convention are determined based on a BIT concluded by the State. The tribunal stated that the language of this Article indicating this is clear and that the claimant’s claim alleging the abuse of the ICSID mechanism (dissenting opinion in the Tokios Tokelés case) cannot be upheld. The tribunal then stated that the relevant BIT clearly defines an “investor” to be “any corporation established in conformity with the laws and regulations of the Contracting State” and no grounds are shown for narrowing the interpretation. Consequently, a decision was rendered that the claimant is a corporation established in the Netherlands and therefore falls under the category of an investor under the relevant BIT.

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

  b) 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.

SGS, a Swiss company, entered into an agreement to provide pre-shipment inspection services to the government of Pakistan. Because the Pakistani government 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**

Based on the “umbrella clause” in the relevant BIT, the arbitral tribunal has the authority to exercise jurisdiction over cases regarding breach of contract. However, as long as the relevant contract chooses the national court as a dispute settlement body, there is no possibility that a request for arbitration will be accepted in this case.

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 case, and, therefore, would 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.

* Subject matter jurisdiction is also examined when the claimant (investor) insists on extending the provisions provided for in a BIT between a non-party country and the host country, based on the most-favored nation clause in the BIT between the investing country and the host country, and when it is related to the jurisdiction of the arbitral tribunal. (For examples, refer to 2) (b) (i) and (ii)

(c-1) Jurisdiction *Ratiorne Temporae* (Jurisdiction over the Timing): Concerning Conflicts of Views and Legal Disputes among Related Parties before a BIT Comes into Effect

(i)  *Empresas Lucchetti S.A. and Lucchetti Peru S.A. v. Peru* (ICSID Case No. ARB/03/4), [Jurisdiction Award], February 7, 2005

**Summary of the Award**
When judging the identity of disputes, the identity of the subject matter is an essential element. Furthermore, it should be reviewed whether the facts and consideration from which the initial dispute arose continue to be the key in subsequent disputes.

Lucchetti Peru, a subsidiary company of Lucchetti (Chile) in Peru, intended to construct a pasta factory in the vicinity of the environmentally protected area in Lima, but Lima city issued an order to disapprove the construction in 1997 on the grounds of the need to preserve the environment and the claimants’ violation of law. Lucchetti Peru fought against the order in national court and the order was revoked the following year. Therefore, the company constructed the factory and started operation. However in 2001, Lima city issued an order to suspend the license and close the factory. Empresas Lucchetti and Lucchetti Peru submitted the dispute for arbitration, alleging that the order breached the BIT. The government of Peru asserted that this case is out of the jurisdiction _ratione temporae_ of the arbitral tribunal on the grounds that the dispute was identical to the one that arose from the order issued in 1997 and that the Chile-Peru BIT, which came into effect on August 3, 2001, provides in Article 2 that “the BIT shall not apply to any conflicts of views or disputes that arise before the BIT comes into effect.”

The arbitral tribunal held that the order issued in 2001 aimed to establish a framework for regulations for the environmentally protected area and pointed out that the preface of the order refers to the fact that the claimants’ violation of law since 1997 had caused bad effects in the area, as well as the developments of the disputes with the claimants since 1997. Admitting that the dispute in 1997 and 1998 and the dispute in 2001 originated from the same source, i.e. a conflict between efforts by Lima city to ensure the implementation of its environmental preservation policies and efforts by the claimants to suspend the application of the relevant policies to their factory, the tribunal rendered an award that the dispute in question became crystallized by 1998 and continued to exist up to 2001.

* A request to annul this award was filed by the claimants but dismissed by the special committee on September 5, 2007.

(ii) _Jan de Nul N.V. and Dredging International N.V. v. Egypt_ (ICSID Case No. ARB/04/13), [Decision on Jurisdiction], June 16, 2006

(Case where it was admitted that disputes before and after a BIT comes into effect relate to each other but constitute different “legal disputes”)

Jan de Nul, a Belgian company, concluded a contract concerning dredging of the Suez Canal with the Suez Canal Authority in 1992. The company submitted this case to arbitration, alleging that the government of Egypt committed fraud concerning significant information upon concluding this contract and that the decision rendered by the Egyptian administrative court in 2003 that did not uphold the alleged fraud was in breach of the relevant BIT. The government of Egypt objected to the jurisdiction of the arbitral tribunal on the grounds that the relevant BIT, which came into effect in 2002, provided in Article 12 that “the BIT shall not apply to any disputes that arise before the BIT comes into effect,” while covering investments made prior to the effectuation as those to be protected.

The arbitral tribunal held that the purport of Article 12 is to exclude any disputes that became “crystallized” before the effectuation of the BIT and are deemed to be “conventional disputes,” and affirmed the jurisdiction of the tribunal by pointing out that the actions taken
by the government of Egypt up to the rejection of remedies by the administrative court increased the damage and that actions under the court system are different from contracts.

(iii) **Chevron Corp. and Texaco Petroleum Corp v. Ecuador** [Interim Award], Ad hoc—UNCITRAL, December 11, 2008

**Summary of the Award**

a) The temporal scope of a BIT and the jurisdiction *ratione temporae* of the arbitral tribunal are determined according to the intentions of related countries that are admitted through the interpretation of the provisions of the BIT.

b) “Investments” under the relevant BIT are supposed to cover a broad scope, and are to be protected under the relevant BIT during the entire period from the commencement to the final completion of the investment, including the period for the settlement and lawsuits concerning debt disposal.

Texaco Petroleum (U.S.), which is a wholly-owned subsidiary of Chevron Corporation (U.S.), signed a concession agreement concerning oil exploitation with the government of Ecuador and other related parties in 1973 and then signed a supplemental agreement in 1977. Negotiations to extend the 1973 agreement fell apart and the agreement expired on June 6, 1992. The claimants filed breach-of-contract cases against the Ecuadorian government in Ecuadorian courts from the end of 1991 to the end of 1993, alleging that the Ecuadorian government breached the agreements through actions such as acquiring oil in excess at domestic market prices, but no decision was rendered. Therefore, the claimants submitted the case to arbitration in December 2006, based on the U.S.-Ecuador BIT, which came into effect on May 11, 1997, alleging that the egregious delays in trial and the government’s interference in the judiciary constitute the rejection of trials under the relevant BIT and customary international law. The Ecuadorian government objected to the jurisdiction of the arbitral tribunal on the grounds that the actions and the facts, on which the complaint in question was based, took place or extinguished before the effectuation of the BIT and are not subject to the jurisdiction *ratione temporae* of the BIT.

Reviewing the language of the BIT, the arbitral tribunal stated that investments under the relevant BIT cover a broad scope, including the settlement of investment and lawsuits concerning debt disposal, and once investments were made, they are to be protected under the BIT until being completely settled. The arbitral tribunal continued that as long as lawsuits on the agreements with the Ecuadorian government proceed, the investments did exist at the time of the effectuation of the BIT, as well as at the time of the commencement of arbitration, and pointed that the issue is not the retroactive application of the BIT but how to interpret the provisions. The tribunal concluded that the relevant BIT should apply to “investments that exist at the time of its effectuation” and that the claimants’ investments had already existed when the relevant BIT came into effect.

Admitting the jurisdiction over requests under customary international law, the arbitral tribunal held that an “investment agreement” concerning “investments” protected under the relevant BIT is also to be protected, and admitted its jurisdiction over disputes concerning the rejection of trials that started after the effectuation of the BIT, with regard to a concession agreement reached before the effectuation.
Part III Chapter 5 Investment

(iv) Société Générale v. the Dominican Republic (LCIA Case No. UN 7927) [Award on Preliminary Objections to Jurisdiction], Ad hoc—UNCITRAL, September 19, 2008

Summary of the Award

a) The language of the relevant BIT does not show any clear intention to apply the convention retroactively, and the arbitral tribunal shall have the jurisdiction only over actions or events after the effectuation of the BIT.

b) When any action taken before the effectuation of the BIT continues and is proved to constitute a breach of the convention at the time of this case, such action shall be subject to the jurisdiction of the arbitral tribunal.

Société Générale, a French company, which made an investment in an electricity company established in the Dominican Republic based on a joint venture agreement with the Dominican government, filed arbitration by alleging a breach of contract, etc. by the country. In response, the Dominican government asserted that the BIT shall not apply retroactively and objected to the jurisdiction of the arbitral tribunal, alleging that the actions and events on which the relevant complaint is based took place prior to the acquisition of the property by the claimant, who is a French national, or the effectuation of the BIT, and therefore the tribunal does not have the jurisdiction over this case.

Stating that conventions, in principle, shall not apply retroactively and that the relevant BIT contains no clear intention to be applied retroactively, the tribunal decided that it had jurisdiction only over a breach of the convention regarding actions or events that took place after the BIT came into effect. However, the tribunal added that if any actions taken before the effectuation of the BIT continue and were proved, at the time of this case, to constitute a breach of the convention that came into effect afterwards, the jurisdiction of the tribunal would cover such actions as well.

Furthermore, regarding the objection concerning the claimant’s nationality, the tribunal held that the language of the BIT shows that it aims to protect only nationals and companies in contracting parties, and concluded that as the relevant investments are not to be protected under the BIT until they are owned by the claimant, the tribunal does not have jurisdiction over actions and events prior to that moment.

(c-2) Jurisdiction Ratione Temporae (Jurisdiction over the Timing): Provisional Application of the Energy Charter Treaty

Ioannis Kardassopoulos v. Georgia (ICSID Case No. ARB/05/18), [Decision on Jurisdiction], July 6, 2007

Summary of the Decision

a) The scope of the provisional application set forth in Article 45(1) of the ECT is the entirety of the treaty.

b) Even in the case where a country has not declared that it is not able to accept provisional application based on Article 45 (2)(a) of the ECT, if the treaty is
inconsistent with its constitution, laws, or regulations, the country is not obliged to apply the ECT provisionally.

The claimant, who is a Greek national, alleged that the company whose shares he/she holds concluded a concession contract concerning pipelines with Georgia but Georgia expropriated the contact, and submitted the case to arbitration based on the ECT and the Greece-Georgia BIT. Greece and Georgia signed the ECT on December 17, 1994, and the ECT came into effect on April 16, 1998. As the event in question occurred around that time, how to interpret the provisional application prescribed in Article 45 of the ECT became an issue.

The arbitral tribunal reviewed the language of Article 45(1), which provides that “this treaty” shall provisionally apply, and Article 31(3)(c) of the Vienna Convention on the Law of Treaties, and construed that the provisional application set forth in Article 45 shall be interpreted to mean that the ECT is to apply upon the effectuation of the entire treaty. Furthermore, the tribunal held that even without a declaration prescribed in Article 45(2)(a), if the treaty “is inconsistent with the constitution, laws, or regulations of respective countries,” they are not obliged to apply the ECT provisionally, but that the respective countries bear the burden of proof of the inconsistency. Examining the national laws of Georgia and Greece, the tribunal found no conflict in either of them, and concluded that the ECT was to be applied provisionally for both countries from December 17, 1994, to April 16, 1998.

Provisional application of the Energy Charter Treaty:

Article 45(1) of the Energy Charter Treaty provides that “Each signatory agrees to apply this Treaty provisionally pending its entry into force …, to the extent that such provisional application is not inconsistent with its constitution, laws or regulations.” Article 45(2)(a) provides that “Notwithstanding paragraph (1), any signatory may, when signing, deliver to the Depository a declaration that it is not able to accept provisional application. The obligation contained in paragraph (1) shall not apply to a signatory making such a declaration. …” At present, the Republic of Belarus has signed but has not ratified the ECT, and has not delivered a declaration of not accepting provisional application. Therefore, it is construed that the ECT is provisionally applicable to the Republic of Belarus.

(d) 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

A promissory note constitutes “title to money” and therefore is an “investment” protected under an investment protection agreement.

*Fedax N.V.*, a Dutch enterprise, requested arbitration claiming payment was owed on Venezuelan government-issued promissory notes it owned. Venezuela 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 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 tribunal held that the promissory notes were “investments” provided in the BIT or ICSID Convention.

Reference: Article 25 (1) of the ICSID Convention provides that:

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

(ii) Salini Construttori S.P.A. and Italstrade S.P.A. v. Kingdom of Morocco (ICSID Case No. ARB/00/4), [Decision on Jurisdiction], July 23, 2001

Summary of the Decision

a) For the arbitral tribunal based on the ICSID Convention to have jurisdiction, the right concerned must relate not only to an “investment” as defined in the BIT but also “investment” as used in the ICSID Convention.

b) When determining whether it falls under the category of “investment” under the ISCID Convention, [i] economic contribution, [ii] the period of time for which the contract was implemented, [iii] sharing of risks on the transaction, and [iv] contribution to the economic development of the host country are all taken into consideration.

Salini, an Italian company, requested arbitration, claiming that the company suffered damage since its contract for road construction with the Société Nationale des Autoroutes du Maroc, a private entity financed by the Moroccan government, was terminated. The Moroccan government objected to the jurisdiction of the arbitral tribunal, insisting that the claimant’s contract for highway construction does not fall under the category of an “investment” as defined in the Italy-Morocco BIT nor an “investment” under the ICSID Convention.

As shown in a) above, the arbitral tribunal first held that the contract concerned falls under the category of an “investment” as defined in the BIT, holding that the contract satisfies all of the elements of “investment” in the ICSID Convention as shown in b) above by referring to the commentary and the preamble to the ICSID Convention. Firstly, the tribunal affirmed the “economic contribution,” citing that the claimant had provided know-how, necessary equipment and capable personnel. Regarding the contract term, the tribunal held that the contract fulfilled the requirements of a minimum term of 2 to 5 years, because the
Part III Chapter 5 Investment

duration was 32 months at the beginning and 36 months after the extension. With regard to risks, the tribunal stated that definite costs cannot be determined in advance for a long-term construction project, making it a clear risk for a contractor. Lastly, the tribunal affirmed the claimant’s contribution to the economic development of the host country, based on the public interest and the know-how provided upon the construction.

* The case settled before the decision was made.

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

- Summary of the Decision

a) The definition of “investment” in the BIT, that determines whether arbitration is appropriate, governs the interpretation of “investment” in Article 25 of the ICSID Convention.

b) The scope of “investments” covered by BITs is wide, and does not necessarily require the cross-border transfer of capital.

The Ukrainian government argued that the claimant had not shown that the source of capital used for its fundraising was non-Ukrainian, and therefore did not constitute an “investment” as defined in Article 25 of the ICSID Convention and in the Ukraine-Lithuania BIT. 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. Therefore, it 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 the BIT.

(iv) *Joy Mining Machinery Ltd. v. Egypt* (ICSID Case No. ARB/03/11), [Award on Jurisdiction], July 30, 2004

- Summary of the Decision

a) For the arbitration based on the ICSID Convention to have jurisdiction, the right concerned must relate not only to an “investment” as defined in the relevant BIT but also an “investment” as used in the ICSID Convention.

b) An ordinary sales contract does not qualify as an “investment” under Article 25 of the ICSID Convention and disputes arising from the relevant contract are not subject to the jurisdiction of the ICSID arbitration.

Joy Mining, a British company, concluded a contract for providing equipment necessary for the mining of a phosphate mine with the Egyptian government and offered letters of guarantee for contract performance and advance payment to the government. The Egyptian government paid for the total cost of introduced equipment but insisted that the relevant letters of guarantee should not be returned until full operation of the equipment is confirmed. Joy Mining requested arbitration, alleging that this action constitutes a breach of
Firstly reviewing whether or not the bank guarantee in question relates to an “investment” as defined in the relevant BIT, the arbitral tribunal decided that the relevant guarantee is simply a contingent liability and cannot be regarded as an “investment” to be protected under the BIT. Furthermore, the tribunal pointed out that even if the counter performance and the return of the letters of guarantee hold a financial value, a dispute on a bank guarantee in essence will never develop into an investment dispute.

Furthermore, regarding Article 25 of the ICSID Convention, the arbitral tribunal held that in order to be recognized as an “investment” as defined in that Article, the contract needs to satisfy the relevant requirements (a certain duration, profits on a regular basis, sharing of risks, economic contribution in real terms, and contribution to the economic development of the host country), and judgment should be made by reviewing the entirety of the activities. The tribunal stated that the clauses of this contract, including bank guarantees, are those for an ordinary sales contract and include no reference to investment under the contract, and also pointed out that, in addition to the fact that no Egyptian system for investment was used, the production and supply of the kind of equipment involved in this case is a normal activity of the company, not having required a particular development of production that could be assimilated to an investment on behalf of the demands of the Egyptian government. The payment finished at an early stage and there were no profits arising on a regular basis. The risks here are not different from those involved in any commercial contract, and although bank guarantees are economic contributions in real terms, such contributions are only limited to a part of the projects that can be recognized to have contributed to the economic development of the country. Holding such a view, the tribunal stated that this contract was far from any concession contracts for public works, and that investment contracts should be kept distinct from sales or procurement contracts involving a State agency, except in exceptional circumstances, for the sake of stable legal order.

The arbitral tribunal concluded that this case is out of the scope of the relevant BIT and the ICSID Convention and the tribunal does not have the jurisdiction over this dispute.


**Summary of the Award**

Four requirements for falling under the category of “investments” under Article 25 of the ICSID Convention are unique for the convention and are not to be applied to the case of an ad-hoc arbitration prescribed in the BIT as an alternative other than the ICSID.

(vi-1) *Malaysian Historical Salvors Sdn Bhd v. The Government of Malaysia*, ICSID Case No. ARB/05/10, Decision on Jurisdiction, May 17, 2007

**Summary of the Decision**
a) For the arbitral tribunal based on the ICSID Convention to have jurisdiction, the right concerned must be not only “investment” as defined in the BIT but also the “investment” as used in the ICSID Convention.
b) When determining whether it falls under the category of “investment” in the ICSID Convention, the 4 factors set out in the decision on Salini (iii) above are important, but other factors also should be taken into consideration depending on the issues in dispute.

Malaysian Historical Salvors, a British company, signed a contract with the Malaysian government to discover and raise a sunken ship. Per the contract, the company had to bear the cost of research and raising the ship, and the reward was to be paid to the company only if the raising of the ship and the subsequent auction were successful. The company submitted to arbitration a claim that the payment by the Malaysian government did not satisfy the amount in the contract. The Malaysian government objected to the jurisdiction of the arbitral tribunal, claiming that the company's contract did not constitute an “investment” as defined in the ICSID Convention.

Referring to arbitral precedents related to “investment” as used in Article 25 of the ICSID Convention, the arbitral tribunal made the two statements set out above in the “Summary of the Decision.” It examined the extent to which the characteristics of “investment” were satisfied. It held that it did not have jurisdiction over the case, based on the following reasons: (1) the factor of regularity of profit does not exist in this contract, (though this factor is not particularly decisive); (2) economic contribution is affirmative, since the company provided equipment, know-how and personnel; (3) the contract term is satisfied quantitatively, but not qualitatively when considering the factor of economic development stated below; (4) regarding risks, the contract may be said to be superficially risky, but the company did not prove that the risk exceeded normal commercial risks; and (5) the economic contribution to the host country must be a significant contribution, and the profit from this contract is not a significant contribution to the public interest and economy of the host country, since it does not have continuity, unlike infrastructure or financial projects.

* The claimant applied for annulment.

(vi-2) Malaysian Historical Salvors Sdn. Bhd. v. The Government of Malaysia (ICSID Case No. ARB/05/10), [Decision on the Application for Annulment], April 16, 2009

Summary of the Decision

The term “investment” as used in Article 25 of the ICSID Convention only means that the dispute in question should be a legal dispute and related parties should be a Contracting State and a national of another Contracting State.

After the aforementioned decision – 1)(d)(vi-1) – was rendered, Malaysian Historical Salvors applied for the annulment of the decision on jurisdiction, stating that the arbitral tribunal interprets the term “investment” in Article 25(1) of the ICSID Convention excessively narrowly, against the process of drafting the Convention, and that the four cited requirements are not derived from the main clause of the ICSID Convention and are inconsistent with their ordinary terminology. In response, the Malaysian government asserted that “investment” in that Article refers to investment for the economic development of the
host country but the company’s investment does not have such aim and therefore is not under the jurisdiction of the arbitral tribunal.

The ad-hoc committee, admitting that the contract among the related parties falls under the category of “investment” under the relevant BIT, pointed out that as Article 7 of the BIT limits the submission of disputes only to ICSID arbitration, it is difficult to construe that both Contracting States knew that the submission of disputes over an “investment” under the relevant BIT is limited due to how the term “investment” is defined under the ICSID Convention.

The committee stated that provisions without a clear definition of the term “investment” were adopted intentionally in the process of drafting the ICSID Convention and have been used as the decisive criteria for related parties to reach an agreement on jurisdiction, and that the outer limits of the jurisdiction prescribed in Article 25(1) of the convention are only that the dispute should be a legal dispute; related parties should be a Contracting State and a national of another Contracting State; and the contract is not that for sales. Accordingly, the committee decided that the arbitrator made a mistake in reviewing the definition of the term “investment,” resulting in a significant error of failing to execute its jurisdiction.

Against this decision, committee member Shahabudeen expressed an opinion to oppose the annulment, by reviewing the preamble to the ICSID Convention, stating that “investment” under the convention refers to investment contributing to the economic development of a host country and that such contribution should be substantial or significant.

(vii) Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines, ICSID Case No. ARB/03/25, Award, August 16, 2007

Summary of the Award

The Germany-Philippines BIT clearly limits the protection to the investment that is legal under Philippine law. When a claimant makes investment that violates the domestic law, being fully aware of this illegality, the investment concerned does not constitute an “investment” as defined in the BIT.

Fraport, a German company, invested in PIATCO, which entered into a contract with the Philippines government for the construction of an airport terminal. The contract was opposed by domestic companies in related businesses, and its illegality was alleged. The Philippines government at first tried to renegotiate the contract, but finally judged that it was invalid from the beginning since it did not satisfy the corresponding contract’s requirement for capital. The government nationalized the terminal, which was almost complete, and expressed its intention to offer compensation. While these processes were underway, Fraport submitted to arbitration based on the Germany-Philippines BIT. The Philippines government objected to the jurisdiction of the arbitral tribunal.

The arbitral tribunal held that it did not have jurisdiction over the case. In its determination, the arbitral tribunal referred to three Articles in the BIT, including the definition of invested assets and the instrument of ratification, and held that conformity to domestic laws was an important condition for being protected by the BIT. The tribunal also understood that this condition meant that conformity at the time of investment, and the
illegality of activities after the investment, must be examined by this tribunal. Based on the foregoing, the secret shareholder agreement whose existence was revealed during the process of arbitration (rather than the violation that became an issue in the Philippines at the beginning) violated the domestic law that limited the management of national enterprises by foreigners. Pointing out that this violation was made as a secret agreement – with full awareness of the illegality based on legal advice – the arbitral tribunal held that the investment concerned did not constitute an “investment” protected by the Germany-Philippines BIT.

The claimant applied for annulment.

(viii) **Plama Consortium Limited v. Republic of Bulgaria** (ICSID Case No. ARB/03/24), [Decision on Jurisdiction], August 27, 2008

Summary of the Decision

Definition of the term “investment” under the ECT does not contain any language indicating the requirement of consistency with specified laws, but for any investment made in violation of national laws or applicable international laws, the protection under the ECT can be denied.

Plama, a Cypriot company, requested arbitration on the grounds that an action of the Bulgarian government toward Nova Plama in Bulgaria, whose shares Plama acquired upon its privatization, is in breach of the ECT. The Bulgarian government objected to the jurisdiction of the arbitral tribunal, alleging that it thought the shares of Nova Plama in question were to be sold to a joint venture established by André & Cie (André) and Norwegian Oil Tradings (NOT), but the claimant acquired the shares by misrepresenting that fact, in other words, through fraudulent misrepresentation. The claimant insisted that the memorandum of understanding (MOU) of the share purchase agreement says that the shares are to be transferred to “a company presented by NOT and André” but that this does not refer to a joint venture established by these two companies.

The arbitral tribunal referred to documents exchanged between the related parties upon the privatization of Plama and stated that the Bulgarian government believed that the purchaser of the shares was a joint venture established by the two companies, and that under the recognition that the purchaser’s financial and technological capabilities are important for this contract, the Bulgarian government would not have sold the shares if it had known that an individual, who did not have sufficient assets, was going to purchase the shares in a company’s name. Furthermore, the tribunal admitted that the claimant was obliged to tell the government that the company was not a joint venture by the two companies, but intentionally neglected to do so. The tribunal held that the claimant’s investment constitutes fraud and admitted the breach, stating that the principle of good faith under Bulgarian contract laws encompasses, in principle, the obligation for contractors to provide all related facts upon concluding a contract. In contrast to other BITs, the ECT does not contain any language indicating the requirement of consistency with specified laws, but leaves a possibility of a breach of “applicable rules and principles of international law” (Article 26, paragraph (6)). Referring to past arbitration decisions, the arbitral tribunal decided that the claimant’s acts were in breach of the principle of good faith under international law and concluded that the claimant’s investment may not be protected under the ECT.
* Refer to 2)(b-1)(ii) below for the award concerning the most-favored-nation treatment in the decision on jurisdiction.

(ix)  
Romak S.A. v. Uzbekistan (PCA Case No. AA280), [Award], Proceedings based on UNCITRAL Arbitration Rules, November 26, 2009

Summary of the Award

a) An “investment” as defined in the BIT holds “an inherent meaning” and the scope of an “investment” does not change irrespective of whether the investor resorts to ICSID or UNCITRAL arbitral proceedings.

b) The “investment” as defined in the relevant BIT means a “contribution” that extends over a “certain period of time” and that involves some “risk.”

Romsak, a Swiss company, concluded a contract for the supply of wheat with the government of Uzbekistan. The company, which had performed the contract but was not paid for it, requested arbitration for a breach of the contract and the request was accepted. However, the arbitration award was not executed smoothly, so the company requested arbitration based on the Switzerland-Uzbekistan BIT. The government of Uzbekistan objected to the jurisdiction of the arbitral tribunal, alleging that the supply contract in question and the arbitration award concerning the breach of the contract do not fall under the category of the “investment” under the relevant BIT.

The arbitral tribunal held that the investments listed in Article 1(2) of the relevant BIT, which defines the term “investment,” are examples and that their scope shall be determined through interpreting the provisions in line with the Vienna Convention on the Law of Treaties. As Article 9(3) of the relevant BIT provides for the possibility to resort to ICSID arbitration, in addition to proceedings based on UNCITRAL arbitration rules, the tribunal stated that it is unreasonable and irrational to construe that the definition of the term “investment” as well as the scope of the protection under the BIT vary depending on where to submit the case and that such interpretation also contravenes the general rule that the same wording shall have the same meaning in the same context. Furthermore, the tribunal pointed out that contracting party countries may include all assets and transactions in “investments” by clearly defining the term in BITs but the relevant BIT does not contain any provisions to show the intention of contracting party countries to add special meanings to the term. Consequently, the tribunal found that the term “investment” in the relevant BIT holds “an inherent meaning,” referring to a “contribution” that extends over a “certain period of time” and that involves some “risk,” irrespective of whether the investor resorts to ICSID or UNCITRAL arbitral proceedings.

Regarding this case, the arbitral tribunal firstly decided that the arbitration award based on contractual breaches cannot be an “investment” as long as the contract, the preface of the arbitration, does not fall under the category of an “investment” under the relevant BIT. Then, the tribunal stated that regarding “contracts and economic relations entered into with Uzbek public entities,” Romsak’s wheat delivery cannot be recognized as a contribution in relation to that transaction unless it aims to promote investment, and that it was the first and last economic transaction. The tribunal also pointed that risks assumed by Romsak in this case were not the investment risks of the unpredictability of transaction results, but only the usual risks of non-performance that are often to be assumed by contracting parties.
Accordingly, the arbitral tribunal denied the jurisdiction on the grounds that the claimant did not own “investments” under Article 1 of the relevant BIT.

(e) Exclusion of Matters of Taxation

(i) *Occidental Exploration and Production Company v. The Republic of Ecuador* (LCIA Case No. UN3467), [Final Award], Proceedings based on UNCITRAL Arbitration Rules, July 1, 2004

Summary of the Award

The arbitral tribunal shall have the jurisdiction even over disputes concerning matters of taxation as long as they relate to the observance and enforcement of investment contracts under the relevant BIT.

Occidental, a U.S. company, concluded a contract for the provision of services with Petroecuador, a state–owned corporation of Ecuador, to undertake exploration for and production of oil in Ecuador. The company applied to the Servicio de Rentas Internas (SRI; national tax administration) for the reimbursement of Value–Added Tax it had paid on purchases required for its exploration and exploitation activities under the contract and the ultimate exportation of the oil produced. Such reimbursement was made on a regular basis. However, after the contract was changed into a participation contract in line with the amendment of the Ecuadorian law, SRI suspended the reimbursement and decided to demand the return of the money already reimbursed. Occidental requested arbitration, alleging that this action constituted a breach of the U.S.-Ecuador BIT. The government of Ecuador objected to the jurisdiction of the arbitral tribunal, asserting that the VAT and the reimbursement thereof fall under the tax exclusion set forth in Article 10 of the relevant BIT.

Article 10(2) of the BIT provides that the provisions of this Treaty shall apply to matters of taxation only with respect to (a) expropriation, pursuant to Article 3, (b) transfers, pursuant to Article 4, and (c) the observance and enforcement of terms of an investment agreement or authorization as referred to in Article 6.

The arbitral tribunal firstly dismissed the claimant’s allegation, stating that the allegation that the relevant tax exclusion applies only to matters of direct taxation lacks persuasiveness. Then, the tribunal pointed out that this case involves neither transfers nor expropriation and the issue is whether or not this dispute relates to the observance and enforcement of an investment contract prescribed in Article 10(2)(c) of the BIT. The tribunal affirmed its jurisdiction, holding that this case is a dispute over whether the reimbursement of VAT is included as a factor of the participation contract and that this dispute relates to the observance and enforcement of the investment contract.

* Refer to 2)(a)(iii) below for the award concerning the national treatment.

(ii) *EnCana Corporation v. The Republic of Ecuador* (LCIA Case No. UN3481), [Award], Proceedings based on UNCITRAL Arbitration Rules, February 3, 2006

Summary of the Award
Measures concerning the reimbursement of VAT taken by the government authority in conformity with related laws fall under taxation measures that are provided to be excluded under Article 12, paragraph (1) of the relevant BIT and are not covered by the jurisdiction of the arbitral tribunal except for cases falling under exclusion under the BIT.

EnCana, a Canadian company, concluded a participation contract with Petroecuador, a state–owned corporation of Ecuador, via its subsidiary Ecuadorian corporation, to undertake exploration for and production of oil in Ecuador. The Servicio de Rentas Internas (SRI; national tax administration) had accepted the reimbursement of VAT on goods and services that the company used for the production of oil for export, but later suspended the reimbursement and decided to demand the return of the money already reimbursed. EnCana requested arbitration, alleging that this action constituted a breach of the Canada-Ecuador BIT. The government of Ecuador objected to the jurisdiction of the arbitral tribunal, asserting that the entitlement to the reimbursement of VAT falls under the taxation measures set forth in Article 12(1) of the relevant BIT. Article 12 of the BIT provides in paragraph (1) that “Except as set out in this Article, nothing in this Agreement shall apply to taxation measures” and as the exception, it provides that this Treaty shall apply to “a claim by an investor that a tax measure of a Contracting party is in breach of an agreement between the central government authorities of the Contracting parties” (paragraph (3)), and that Article 8, concerning expropriation, may also apply to tax measures (paragraph (4)). The arbitral tribunal reviewed the issue of jurisdiction together with this case.

Firstly, the tribunal stated that the term “tax measures” in question should be interpreted pursuant to the ordinary meaning in the context of the Treaty and admitted as follows: the relevant measures are [i] measures to be taken under the law; [ii] “taxes” include not only direct taxes but also indirect taxes such as VAT; [iii] decisions regarding the amount of tax or reimbursement also fall under “measures”; and [iv] whether the relevant measures fall under “tax measures” is not a matter of economic effects but the operation of law. The tribunal then stated that, even though the application of rules on VAT by SRI was inconsistent as claimed by the claimant, the relevant measures were taken by tax officials in conformity with related laws and were also subject to a court hearing, and therefore they fall under “tax measures.” The tribunal stated that this case is not a claim on breach of an agreement with the central government and does not fall under what is prescribed in Article 12, paragraph (3) of the BIT, and that it is therefore out of the applicable scope of the BIT except for Article 8 concerning expropriation, and concluded that the tribunal does not have the jurisdiction over this case.

(iii) Duke Energy Electroquil Partners and Electroquil S.A. v. Ecuador (ICSID Case No. ARB/04/19), [Award], Agreement on U.S.-Ecuador BIT and Individual Arbitration, August, 18, 2008

Summary of the Award

Although the relevant BIT provides the exclusion from application of the BIT with regard to “matters of taxation” other than specified matters listed, claims on customs duties are “matters of taxation” and therefore such claims are out of the jurisdiction of the arbitral tribunal.

Duke Energy, a U.S. company, acquired shares of Electroquil, a power generation company created and incorporated under the laws of Ecuador. Electroquil concluded a power
purchase agreement (PPA) with state-owned INECEL and supplied power. Based on the PPA concluded in 1996 that stipulates tax-free importation of “goods required to generate electricity,” Electroquil imported turbines free of customs duties, but one of the turbines broke down in 1998. The customs law was amended later, and Electroquil’s request for the exemption of customs duties for the import of a new turbine was rejected. Regarding the claimant’s allegation of a breach of the BIT, the arbitral tribunal’s jurisdiction was challenged. The tribunal held that claims on customs duties are “matters of taxation” excluded by virtue of Article 10(2) of the relevant BIT. The claimant alleged that the jurisdiction is to be affirmed on the grounds of Article 10(2)(c) that provides that the BIT shall be applied exceptionally to matters concerning the observance and enforcement of terms of an investment agreement or authorization. The tribunal held that the PPA in question was not concluded between Duke Energy and the government of Ecuador and does not fall under an “investment agreement” as prescribed in that Article, and consequently denied the jurisdiction over the claim on customs duties.

* The arbitral tribunal admits other breaches. Refer to 2)(c)(v) and 2)(e)(iv) below.

2) Awards on Substantive Obligations

(a) National Treatment


**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 for treating PCB waste obtained in Canada in the U.S. 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. 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 deciding whether there was any action contrary to the discipline of national treatment, and that practical impact such as creating a disproportionate benefit for nationals over foreign investors, was significant. Canada claimed the purpose of the restriction was to maintain Canada’s ability to process PCB within Canada. Although the arbitral tribunal found this purpose to be legitimate, it dismissed Canada’s 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 export restrictions under the Canada-U.S. bilateral agreement. These measures applied a complex regime of export quotas to duty-free exports permitted from certain provinces including that in which Pope & Talbot’s Canadian subsidiary was located, but did not impose any restrictions on exports from other provinces. 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 the 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 a 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, the tribunal 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 a value-added tax provided under Ecuadorian tax law was in violation of national treatment under the U.S.-Ecuador BIT. The Ecuadorian government claimed that since Petroecuador, a domestic oil company, was also denied a refund of the 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 accorded to domestic enterprises shall be accorded to foreign investors in “like situations.” The arbitral 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 the 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, the “situation” can be interpreted to relate to all exporters that share such condition.

(iv) **Champion Trading Company Ameritrade International, Inc. v. Arab Republic of Egypt**, ICSID Case No. ARB/02/9, Award, October 23, 2006

**Summary of the Award**

“Like circumstances” are defined as similar situations that should be evaluated in the same business sector or same economic field.

Champion Trading, a U.S. company, et al. requested arbitration, claiming that since compensation was paid to a national cotton company (corresponding to the price differential between market price and the price specified by the government) and not paid to foreign companies including Champion Trading, a breach of the national treatment provision in the U.S.-Egypt BIT had occurred.

The national treatment provision in the investment treaty provided that treatment no less favorable than for domestic enterprises shall be accorded to foreign investors in “like circumstances.” The arbitral tribunal pointed out that, for the compensation to be paid under the system, the cotton had to be purchased not through the market but through the government’s “Collection Center,” with the price specified by the government, and that the companies that purchased from the market (at market price) and the companies that purchased from the Collection Center at the fixed price were very different. The claimant purchased cotton only from the market, and was determined not to be in a comparable situation with other companies in the payment of compensation. Based on the foregoing, the arbitral tribunal concluded that the claimant and other companies were not in “like circumstances,” and, therefore, it would not examine whether or not there was discrimination based on the difference of nationality.

Summary of the Award

a) When claiming violation of Article 1102 of NAFTA, a foreign investor must prove: (1) the government gave treatment to establishment, acquisition, expansion or management; (2) the foreign investor or foreign investment was in “like circumstances” to domestic investors or domestic investment; and (3) the NAFTA member country accorded less favorable treatment to the foreign investor or foreign investments than it accorded to its domestic investors or investments.

b) When determining “like circumstances,” all of the relevant circumstances to which the treatment of state was accorded should be taken into consideration.

UPS, a U.S. company, requested arbitration on the grounds that the customs laws used by the Canadian government favored Canada Post (a state-owned company, which monopolized postal services but not courier services) and was in breach of the national treatment requirement under NAFTA.

First, the arbitral tribunal held that the measures concerned were “treatment.” Second, the tribunal held that, concerning whether UPS and Canada Post were in “like circumstances,” it would take into consideration all the relevant circumstances to which the treatment was accorded. It held that the problem was due to the distinction between Canadian customs’ treatment of postal products and of products imported by courier. Concerning the customs measures, it held that postal traffic and courier traffic were not “like circumstances.” The tribunal pointed out the following three factors as distinctions: (1) a courier notifies a recipient regarding a shipment in advance, allowing customs to check and perform risk assessment; (2) the difference between the voluntary check of the courier and the check by customs staff; and (3) the high degree of safety of courier transport by routing and trading network management. It held that UPS and Canada Post were not in “like circumstances” and so there was not a violation of the national treatment obligation.

(vi) Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. Mexico (ICSID Case No. ARB(AF)/04/05), [Award], NAFTA, November 21, 2007

Summary of the Award

a) The object of Article 1102 (National Treatment) of the NAFTA is to ensure that a national measure does not upset the competitive relationship between domestic and foreign investors.

b) A breach of the national treatment obligations occurs when a foreign investor has unreasonably been treated less favorably than domestic investors in like circumstances.

The claimants, both U.S. companies, established a joint venture, ALMEX, in Mexico to manufacture High Fructose Corn Syrup (HFCS). The government of Mexico imposed a 20% tax on transactions of soft drinks and syrup using sweetener (including HFCS) other than sugar. The claimants requested arbitration, alleging that this is unfavorable tax treatment for
the HFCS industry compared with the sugar industry in breach of the national treatment obligations.

Firstly, the arbitral tribunal examined whether HFCS manufacturers and the sugar industry in Mexico are in “like circumstances.” Referring to precedents concerning the NAFTA, the tribunal affirmed that they are in “like circumstances” on the grounds that both are part of the same sector and are in a competitive relationship in supplying sweetener to the soft drink and processed food markets. Furthermore, regarding discriminatory treatment, the tribunal pointed out that [i] the tax on HFCS was higher than that on domestic products, and [ii] the tax treatment had the intention and effect of protecting the sugar industry in Mexico, and concluded that the measures taken by the government of Mexico were discriminatory and amounted to a breach of the national treatment obligation.
(b-1) Most-Favored Nation Treatment – Concerning Arbitration Proceedings

(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 grounds 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, a Spanish financial institution. The Spanish government objected to the jurisdiction of the arbitral tribunal on the grounds that the relevant BIT required that a dispute must first 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**

Determining whether the entire arbitration procedures provided by other BITs apply by virtue of most-favored-nation treatment 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 Plama’s Bulgarian subsidiary was in breach of the Bulgaria-Cyprus BIT. The Bulgarian government objected to the jurisdiction of the arbitral 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 reviewed the text of the most-favored-nation obligation, its context, and its object and purpose, and found that there was no decisive evidence that arbitration procedures were covered by 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.

(iii) *Wintershall Aktiengesellschaft v. Argentina* (ICSID Case No. ARB/04/14), [Award], December 8, 2008

**Summary of the Award**

a) The requirements before resorting to arbitration proceedings as prescribed in the dispute resolution clause of the relevant BIT (search for amicable settlement, domestic court proceedings, etc.) are essential factors that can be a preliminary step to arbitration agreement among States.

b) The most-favored-nation clause shall not be construed to apply to dispute-settlement procedures unless it clearly indicates to that effect.

Wintershall Aktiengesellschaft, a German company, requested arbitration, alleging that the measures taken by the Argentine government at the time of the financial crisis that started in 2001 infringed the interests and benefit of the company’s local subsidiary and that such action breached the Germany-Argentina BIT. Article 10 of the BIT provides, as requirements before resorting to arbitration proceedings, that investment disputes should be referred to local courts and no substantive decision be rendered or the disputes continue even after the rendering of a decision for a period of at least eighteen months. Although the local subsidiary in question had not brought the dispute to a local Argentine court, the claimant alleged that pursuant to the most-favored-nation clause in the relevant BIT, the dispute-settlement provision in the Argentina-U.S. BIT, which does not contain the eighteen-month requirement, should apply in this case.

The arbitral tribunal did not admit the application of the most-favored-nation clause and denied the jurisdiction, on the grounds of a) and b) above, as well as the following: c) “activities related to investments” prescribed in the relevant BIT refer to business activities in the territory of the host State rather than to activities related to the settlement of disputes; and d) dispute-settlement procedures under the Germany-Argentina BIT and the Argentina-U.S. BIT are completely different, with available arbitration bodies being different accordingly.

(b-2) **Most-Favored-Nation Treatment – Concerning Substantive Obligations**

(i) *Parkerings-Compagniet AS v. Lithuania*, ICSID Case No. ARB/05/8, Award, September 11, 2007

a) To say that an investor in the BIT contracting party country and in a third-party country are in “like circumstances,” both investors should belong to the same economic or same business sector.

b) Unfavorable treatment of an investor by the BIT contracting party country is permissible, when a legitimate purpose of a state can justify its different
treatment of the invested asset at issue, which results in the condition that both investors are not in “like circumstances.”

Summary of the Award

Parkerings, a Norwegian company, signed a contract with the Vilnius City Government of Lithuania on the design, construction and operation of a public parking system in what was designated as an historic district. It was revealed that the contract violated Lithuanian law and the negotiation for a contract revision encountered difficulties. During this time, government agencies expressed their opinion that the proposed construction of the parking lot did not complement the historic landscape and surroundings of Vilnius City. Vilnius City terminated the contract on the grounds of a failure in the performance of contractual obligations, including providing periodic updates of the project’s progress. The company requested arbitration on the grounds that it was discriminatory in comparison with the treatment of companies in other countries that concluded similar contracts and that it violated the most-favored-nation clause in the Norway-Lithuania BIT.

For the interpretation of “like circumstances” in the most-favored-nation clause, the arbitral tribunal referred to the precedent of Pope & Talbot and stated (a) and (b) above. Based on the foregoing, the arbitral tribunal compared the plan proposed by the claimant and the plans of other companies, and held that they were not “like circumstances” from the viewpoint of the size of the parking facility and proximity to the important cultural district. The Tribunal held that it was not a violation of the most-favored-nation clause.

* Refer to 2)(c)(iv) below for awards concerning the fair and equitable treatment.

* When the BIT that a submission to arbitration is based on contains a most-favored-nation clause, favored treatment under the host country and a third country may sometimes be applied equally, depending on how to interpret that clause. For example, in the case of the telecommunications industry shown in “Major Disputes by Industry” below, the BIT in question did not contain a fair and equitable treatment clause, but the same treatment was prescribed in a BIT between the host country and a third country, and therefore it was construed that the claimant was entitled to receive that treatment pursuant to the most-favored-nation clause in the BIT in question.
Part III Chapter 5 Investment

(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 its fair and equitable treatment obligation. In finding a breach of obligation, the arbitral tribunal, referring to the Preamble of the U.S.-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.

* The Argentine government applied for annulment, which was upheld by an ad hoc committee on September 25, 2007. The award has not yet been annulled.

(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 Polish insurance company, 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, resolutions of the Council of Ministers and reports of the Poland’s Supreme Audit Chamber, 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 but not to IPB, which was in a comparable situation with them. Also, it did not provide Saluka with an opportunity for negotiations with the government in accordance with Saluka’s request. Because IPB’s operations worsened, the central bank decided on forced administration, and IPB was subsequently transferred to another state-owned bank.

The arbitral tribunal stated that, in connection with the fair and equitable treatment obligation provided for in the Netherlands-Czech BIT, 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, thus frustrating the legitimate and reasonable expectations of investors. The tribunal 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.

(iv) *Parkerings-Compagniet AS v. Lithuania*, ICSID Case No. ARB/05/8, Award, September 11, 2007

**Summary of the Award**

a) Breach of fair and equitable treatment obligation is deemed when legal predictability – that the environment at the time of agreement does not change – is denied.

b) The investor will have a right to protection of its legitimate expectations provided it exercised due diligence and that its legitimate expectations were reasonable in light of the circumstances.

(For the facts, refer to (b) (iii) above.) Parkerings claimed that the following acts of Vilnius City breached the fair and equitable treatment obligation: (1) the city did not disclose that the billing method provided for in the contract was against Lithuanian law during the
negotiation of the contract, although the city knew this fact; and (2) the city blocked the company's legitimate expectations that the legal environment would not change, and this was a breach of the fair and equitable treatment obligation.

The arbitral tribunal did not hold that either of the two points constituted breach of fair and equitable treatment, on the following grounds. Regarding (1), mentioning that the company was also researching the legitimacy of the contract with Lithuanian law, it held that the foreign investor investing in Lithuania must have known that the legal base would not be stable when the country's political regime and economy was drastically changing. It also pointed out that the determination of the legitimacy was not based on information available only through the city government. Regarding (2), as the reason it did not constitute a breach of the fair and equitable treatment obligation, the arbitral tribunal stated (a) and (b) as the understanding on the obligation concerned, and pointed out that the expectation that the legal environment would not change was not created by the explicit or implicit promise of Lithuania. The tribunal also held that 1998, when the contract was signed, was a time when the countries of the former Soviet Union were becoming EU members and a time of political transition, and that investors would have acknowledged the risk of changes in laws after signing contracts. Furthermore, it held that it could not be proved that the law was revised to damage the company's investment.

(v)  Duke Energy Electroquil Partners and Electroquil S.A. v. Ecuador (ICSID Case No. ARB/04/19), [Award], Agreement on U.S.-Ecuador BIT and Individual Arbitration, August 18, 2008

Summary of the Award

a) The stability of the legal and business environment is directly linked to the investor’s justified expectations and such expectations are an important element of fair and equitable treatment.

b) To be protected, the investor’s expectations must be legitimate and reasonable at the time when the investor made the investment, and such expectations arise from the conditions that the State offered the investor, which the latter relied on when deciding to invest.

Electroquil, the first private power generator established in Ecuador, concluded a Power Purchase Agreement (PPA) with INECEL, a state-owned entity, and started to supply electricity in 1995. PPAs, which were concluded in 1995 and 1996, contained provisions on [i] the purchase price and the establishment of payment trusts for securing payment, and [ii] INECEL’s entitlement to impose a fine when Electroquil’s supply is below the warranted amount. In 1998, Duke Energy, a U.S. company, acquired a controlling interest in Electroquil. In 1999, INECEL dissolved based on the provisions of laws, and the Ecuadorian government assumed the rights and obligations of INECEL pursuant to an executive decree. As there were disputes between the claimants and the Ecuadorian government over the unpaid amount and the legality of imposing fines and penalties, Electroquil submitted the case to domestic arbitration based on the arbitration agreement. The Ecuadorian Attorney-General objected to the jurisdiction but the objection was dismissed. Finally, the arbitration clause was determined to be invalid based on Ecuadorian law. The claimants alleged that these actions taken by the Ecuadorian government were in breach of the BIT.
The arbitral tribunal examined the possibility of a breach of the fair and equitable treatment obligation from the viewpoints of [i] the performance of the PPAs, [ii] the government’s failure to guarantee payment, and [iii] the language of the arbitration and mediation agreements (Med-Arb Agreements). Regarding the delay in payment and irregular imposition of fines and penalties based on the PPAs ([i]), the tribunal stated that such acts constitute conduct which any contract party could adopt and are thus not capable of amounting to a breach of fair and equitable treatment. Furthermore, the tribunal denied the allegation that Duke Energy had reasonable expectations that there would be no outstanding penalties, by stating that the company should have known about the possibility of fines and penalties at the time of making investment, and so this did not admit a breach of the fair and equitable treatment obligation. Regarding point [ii] above, the tribunal stated that the PPA concluded in 1996 provided for the payment guarantee of the State and that Electroquil’s expectations are not regarded as “mere” contractual expectations. In addition, the tribunal stated that as Duke Energy requested certain guarantees from the State as a condition precedent to its investment, Duke Energy’s expectations are also deemed reasonable. The tribunal thus admitted a breach of the fair and equitable treatment obligation against Electroquil and Duke Energy. With regard to point [iii] above, the Med-Arb Agreements were concluded more than two years after Duke Energy made investment, and the tribunal concluded that their expectations are not to be protected under the fair and equitable treatment standard.

* Refer to 1)(e)(iii) above for the award concerning the exclusion of matters of taxation.

(vi) **Glamis Gold Ltd. v. United States**, [Award], Ad hoc—UNCITRAL Arbitration Rules, June 8, 2009

Summary of the Award

a) The fair and equitable treatment standard under Article 1105 of the NAFTA refers to the minimum standard of treatment that a State must grant to foreigners under customary international law.

b) Since its establishment in the 1920s, there have been basically no changes to that standard, but “bad faith” as a consequence of subsequent evolution shall not amount to a breach of the fair and equitable treatment obligation.

Glamis, a Canadian mining company, which conducts gold mining business in California requested arbitration with the U.S. government, alleging that a series of measures of the federal government and the State of California, including the order to backfill the site, taken out of concerns over the impact on the environment and culture, breach the minimum standard under international law guaranteed by Article 1105 of the NAFTA.

The arbitral tribunal, after confirming that there had been no disputes among related parties over the concept that the fair and equitable treatment standard under Article 1105 of the NAFTA is the minimum standard of treatment demanded by customary international law, examined possible subsequent evolution of the minimum standard established in the arbitration award for the Neer v. Mexico case in 1926, i.e., “an outrage, bad faith, willful neglect of duty, or an insufficiency of governmental action” that is so short of international standards that every reasonable and impartial person would readily recognize its insufficiency. Firstly, as most BITs contain more detailed provisions than customary international law, the tribunal limited the examination targets only to arbitration awards that are deemed to be based
on the minimum standard of treatment demanded by customary international law. Secondly, regarding the scope of the minimum standard under customary international law, the tribunal concluded that the Neer standard may apply even today, except for the requirement of “bad faith,” although the meaning of the language of the standard had changed as time went by. The tribunal stated that as the fair and equitable treatment is an absolute non-contingent standard of treatment, as opposed to the relative standards embodied in national treatment, a breach thereof should be determined based on an objective standard, holding that a breach of Article 1105 of the NAFTA may be exhibited by a “gross denial of justice or manifest arbitrariness falling below acceptable international standards;” or the creation by the State of “objective expectations in order to induce investment” and the subsequent repudiation of those expectations.

The arbitral tribunal asserted that none of the Department of the Interior’s rejection of the claimant’s plan of operations, procedures of the federal government’s review of the plan, or legislation and emergency regulations by the State of California fall under any of the arbitrariness standards mentioned above, nor damage the justifiable expectations of investors. Even considering measures taken by the federal government and the State of California as a whole, the tribunal found no breach of the fair and equitable treatment obligation in this case. Accordingly, the tribunal dismissed the claim by Glamis based on Article 1105 of the NAFTA.

(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 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.

(iv)  *Rumeli and Telsim v. Kazakhstan* (ICSID Case No. ARB/05/16), [Award], July 29, 2008

**Summary of the Award**

a)  The judicial process is usually commenced by private individuals for the purpose of their own interests, but a transfer of assets to a third party may amount to an expropriation attributable to the State if the judicial process was instigated by the State.
The claimants, Turkish companies, established a stock company, KaR-Tel, jointly with a local company and acquired a GSM license. KaR-Tel later concluded a contract for the establishment of a GSM-standard communications network with the Investment Committee. Three years later, the Investment Committee cancelled the contract with KaR-Tel on the grounds of a breach of contract. At the extraordinary general meeting of shareholders convened upon request from the claimants’ local partner, the purchase of the claimants’ shares in KaR-Tel was adopted in the absence of the claimants. Subsequently, the local partner filed a suit against the claimants with a domestic court to purchase the shares in question. The claimants fought against the suit but the Supreme Court permitted forced purchase of the shares. The claimants requested arbitration, alleging that these acts taken by the government of Kazakhstan breach the Turkey-Kazakhstan BIT.

The arbitral tribunal stated as shown in a) above, with regard to expropriation by judicial proceedings. Based on the relationship between the cancellation of the contract by the Investment Committee and the convening of the extraordinary general meeting of shareholders upon request from the local partner, the tribunal admitted that there was a conspiracy between them. The tribunal concluded that this was a case of “creeping expropriation,” instigated by the decision of the Investment Committee to cancel the contract with the claimants, which was then improperly communicated to the local partner, culminating in the final decision of the Supreme Court to admit forced purchase of the shares.

(e) Umbrella Clause

(i) Noble Ventures Inc. v. Romania (ICSID Case No. ARB/01/11), [Award], October 12, 2005

Summary of the Award

When the wording of the umbrella clause is clear, a breach of contract under municipal law can be admitted as a breach under international law.

Noble Ventures, a U.S. company, signed a privatization agreement with the Romanian government and acquired shares of the state-owned steel company CSR. Noble Ventures requested arbitration, alleging that the Romanian government breached the contractual obligations to negotiate CSR’s debt rescheduling with State budgetary creditors in good faith and this constitutes a breach of the umbrella clause in the U.S.-Romanian BIT.

In the umbrella clause providing that “Each Party shall observe any obligation it may have entered into with regard to investments,” the arbitral tribunal noted the wording “shall observe,” “any” obligation, and “with regard to investments.” The tribunal stated that although a breach of municipal law and a breach of international law are considered to be quite different under international law, the wording of this umbrella clause is the most general and direct formulation tending to an assimilation of a breach of contract under municipal law to a breach under international law. However, the tribunal did not express any definitive conclusion as to whether the umbrella clause “perfectly” assimilates “any” breaches under municipal law to breaches of the BIT, unless the breach of contract in this case is clearly proved.

(ii) Sempra Energy International v. The Argentine Republic, ICSID Case No. ARB/02/16, Award, September 28, 2007
Summary of the Award

A commercial breach of contract is not a breach of treaty. The distinction should be based on whether it was a breach of contract as a contracting party or an act practiced by an authorization or power of a sovereign state.

Sempra, a U.S. company, started a gas distribution business after the privatization of the gas industry in Argentina. Sempra asserted that the rate system on a dollar basis corresponding with changes in the U.S. consumer price index, which was based on the laws and ordinances of Argentina, was an important factor in judging investment. Also, it claimed that the overturn of the system by various measures against financial crisis violated the umbrella clause, and requested arbitration.

Referring to the two decisions on SGS discussed previously, the arbitral tribunal held that normal commercial breach of contract is not a breach of treaty. Furthermore, it held that the distinction should be based on whether there was a breach of contract by the government acting as a contracting party or whether the breach resulted from an act practiced by an authorization or power of a sovereign state. Based on the foregoing, it held that the act of the Argentine government was the result of a legal change caused by the government and it was an act that only the government could conduct. As a conclusion, the tribunal held it to be a violation of the umbrella clause.

* Also refer to (b)(i) and (ii) above, since the interpretation of the umbrella clause is also discussed with respect to subject matter jurisdiction.

(iii) _AMTO LLC v. Ukraine_ (SCC Case No. 080/2005), [Final Award], March 26, 2008

Summary of the Award

a) The umbrella clause in the ECT (the final sentence of Article 10(1)) covers contracts between a State and an investor or for investor’s investments (a local company, etc.), but shall not apply when a contracting party is a juridical person other than a State.

b) Article 22 of the ECT provides general obligations so as to “ensure” that State enterprises should fulfill obligations under Part III of the ECT and does not go so far as to impose liability on the State in the event that a state-owned legal entity does not discharge its contractual obligations.

AMTO, a Latvian company, acquired shares of EYUM-10, a Ukrainian company. EYUM-10, which is the largest creditor of state-owned Energoatom, obtained a court judgment concerning the fulfillment of obligations and sought execution based thereon. However, the execution was suspended due to bankruptcy proceedings of Energoatom, and later both parties signed an agreement relating to Energoatom’s outstanding debts to EYUM-10. AMTO requested arbitration, alleging that the action by the Ukrainian government is in breach of the umbrella clause in the ECT.

The arbitral tribunal noted the fact that the related parties of the contract in question are [i] Energoatom, which is a juridical person other than a State, and [ii] EYUM-10, which is
a corporation different from AMTO. Considering that Article 10(1) of the ECT provides that “Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party,” the tribunal affirmed that any contract that involves EYUM-10 as a related party shall be included but stated that the umbrella clause shall not be applied on the grounds of [i] above. Furthermore, as Energoatom is wholly-owned by the State, the tribunal reviewed Article 22 of the ECT, which provides that “Each Contracting Party shall ensure that any State enterprise which it maintains or establishes shall conduct its activities in relation to the sale or provision of goods and services in its Area in a manner consistent with the Contracting Party’s obligations under Part III of this Treaty.”* The tribunal held that Article 22 imposes on the State a general obligation to ensure that state-owned entities conduct activities which, in general terms of governance, management and organization, make them capable of observing the obligations specified under Part III of the ECT and does not go so far as to impose liability on the State in the event that a state-owned legal entity does not discharge its contractual obligations. In conclusion, the tribunal did not admit a breach of the umbrella clause.

* Part III of the ECT defines substantive obligations for protecting investments.

(iv) **Duke Energy Electroquil Partners and Electroquil S.A. v. Ecuador** (ICSID Case No. ARB/04/19), [Award], Agreement on U.S.-Ecuador BIT and Individual Arbitration, August, 18, 2008

(A case where domestic parties have agreed, in an individual arbitration agreement, that the BIT shall apply to contract disputes)

**Summary of the Award**

(Refer to 2)(c)(v) above for the facts of the case.)

Based on the agreement between the parties and Article 25(2)(b) of the ICSID Convention, Electroquil S.A., which is an Ecuadorian corporation and a subsidiary of Duke Energy, shall be treated as a U.S. corporation in this case, and the arbitral tribunal admitted a breach (under municipal law) of the PPA concluded between Ecuador and Electroquil. Regarding the umbrella clause, the tribunal pointed out [i] that the wording of the clause is broad as it refers to “any obligation,” [ii] that there is an express agreement by the parties in the Arbitration Agreement that the BIT applies to contract disputes, and [iii] that an executive decree was specifically issued when Ecuador decided to assume INECEL’s rights and obligations, and found that a breach of the PPA constitutes a breach of the umbrella clause. However, the tribunal did not admit a breach in relation to Duke Energy, and rendered the decision that Electroquil is entitled to compensation.

* Refer to 1)(e)(iii) above for the award concerning the exclusion of matters of taxation.

(f) General and Security Exceptions

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

**Summary of the Award**

898
a) In an economic crisis, the state of necessity may be invoked, under customary international law and the relevant BIT, only in the case where there is a situation of a “total collapse” of the economy.

b) The invocation of the state of necessity shall not depend on self-judgment, but the arbitral tribunal shall consider whether the requirements under international law are met and whether wrongfulness can be precluded.

The Argentine government embarked on economic reforms, which included the privatization of public utilities, and introduced in 1991 a fixed exchange rate system, fixing the Argentine peso on par with the United States dollar. In order to attract foreign investment to privatized gas companies, etc., the government guaranteed the following: [i] tariffs would be calculated in dollars and converted into pesos at the time of billing; [ii] tariffs would be adjusted every six months in accordance with the United States Producer Price Index; [iii] the license would not be altered or abolished without an agreement by a licensee or any breach of laws and regulations or the license, [iv] the neutrality of subsidies would be ensured; and [v] gas charges would not be frozen.

CMS, a U.S. company, acquired shares of TGN, an Argentine gas company, in 1995 under these conditions. However, the Argentine government, after experiencing a serious economic crisis at the end of the 1990s, froze the revision of gas charges in 2000 and established the Emergency Law in 2002 to abolish the fixed exchange rate system. As a result, TGN’s revenue declined sharply. CMS requested arbitration with the Argentine government, alleging that the series of these acts constitute a breach of the U.S.-Argentine BIT. The arbitral tribunal admitted that the government’s act in question constituted a breach of the fair and equitable treatment obligation, etc. (refer to 2)(c)(i) above), and then reviewed the Argentine government’s allegation of the state of necessity based on customary international law and general and security exceptions based on Article 11 of the relevant BIT. Article 11 of the U.S.-Argentine BIT provides that “This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, … or the protection of its own essential security interests.”

The arbitral tribunal firstly reviewed the state of necessity under customary international law in line with the requirements set forth in Article 25 of the draft Articles on International Responsibility, stating that the issue is embodied in that Article. Article 25 of the draft stipulates that necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act ((2)(a) of that Article) not in conformity with an international obligation of that State ((2)(b)), unless the act is the “only way for the State to safeguard an essential interest against a grave and imminent peril ((1)(a))”; and “does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole ((1)(b)).”

The arbitral tribunal pointed out that the economic crisis in question was not a “total collapse” of the economy, having only relative effects, and therefore does not fall under “a grave and imminent peril” that relates to “an essential interest.” Furthermore, the tribunal stated that there were other means available and the acts were not the “only way” nor was there any impairment of the interest of the international community as a whole, and found that the Argentine government policies and their shortcomings significantly contributed to the crisis and the emergency.
Regarding Article 11 of the relevant BIT, the tribunal admitted that economic crises are included in “essential security interests” under the Treaty, but stated that as the Treaty aims to protect investments even under economic difficulties, the defense of necessity cannot be admitted unless a situation of “total collapse” can be observed. The tribunal concluded that this case does not fall under such situation and the circumstances in this case may only be considered for the calculation of the damage.

As to whether or not the relevant provisions depend on the discretionary power of each country invoking the state of necessity, when establishing any rights to unilaterally justify a breach of obligations, a Treaty should contain provisions to that effect clearly, but the relevant provisions do not indicate such effect; therefore the tribunal stated that it shall also consider whether requirements under international law are met and whether the wrongfulness can be precluded.

Accordingly, the tribunal dismissed the Argentine government’s assertion of the state of necessity.

(i-2) *CMS Gas Transmission Company v. Argentine Republic* (ICSID Case No. ARB/01/8), [Decision on Annulment], September 25, 2007

**Summary of the Decision**

a) The provisions on general and security exceptions under the relevant BIT and the state of necessity under customary international law are different from each other in terms of scope, requirements and legal nature, and cannot be treated as identical.

b) Whether or not the case falls under the state of necessity under customary international law should be examined only in the case where a breach is not excluded pursuant to the provisions on general and security exceptions under the relevant BIT, which is to be the primary rule.

In response to the award rendered on May 12, 2005 (refer to 2)(c)(i) above), the Argentine government filed a request for annulment based on Article 52(1) of the ICSID Convention, alleging that the tribunal had manifestly exceeded its powers and that it failed to state the reasons on which it was based.

With regard to the government’s allegation that the arbitral tribunal failed to add any reasons for its award based on Article 11 of the relevant BIT, the ad-hoc committee firstly pointed out that the tribunal treated that Article as identical to the state of necessity under customary international law and construed that unless necessity under customary international law is admitted, a defense under Article 11 shall be dismissed. The committee then stated that this point should have been clearly indicated, but if the arbitration award is read carefully, the reasoning of the tribunal can be well understood. Holding that view, the committee dismissed the government’s allegation on this point.

Regarding the government’s allegation that the tribunal had manifestly exceeded its powers by having treated general and security exceptions under Article 11 of the relevant BIT as identical to the state of necessity under customary international law and having examined the latter in advance of examining Article 11 of the relevant BIT, the committee stated that Article 11 provides the conditions under which the Treaty may be applied and excludes the
application of the substantive obligations under the Treaty, while the state of necessity under customary international law is an excuse where there is a breach of substantive obligations, and that exceptions and the state of necessity differ both in terms of the scope of application and the requirements. On these grounds, the committee determined that the tribunal made manifest errors of law. The committee pointed out that the tribunal should have reviewed firstly whether a breach of the Treaty should be excluded under Article 11 of the relevant BIT, which is the primary rule, and then only if any act not in conformity with the BIT is found, should the tribunal have reviewed whether the responsibility could be precluded in the state of necessity under customary international law, which is the secondary rule. However, although the tribunal erred in its construction of Article 11 of the BIT, the committee concluded that the tribunal applied that Article and cannot be construed to have exceeded its powers.

(ii) BG Group plc. v. Argentina, [Final Award], Ad hoc—UNCITRAL Arbitration Rules, December 24, 2007

Summary of the Award

a) The relevant BIT contains no provisions on the state of necessity.
b) The relevant BIT precludes the invocation of necessity under customary international law against obligations under the BIT.
c) Even if the state of necessity under customary international law is admitted, obligations to pay damages shall not be exempted.
d) The state of necessity under customary international law is a most exceptional remedy subject to “very strict conditions.”

A British corporation, BG, has an indirect ownership interest in MetroGAS, a gas company in Argentina. BG requested arbitration in 2003, alleging that various measures that the Argentine government introduced because of the economic crisis constitute a breach of the Argentina–U.K. BIT. The arbitral tribunal determined that the measures taken by the Argentine government were in breach of the fair and equitable treatment obligation and the prohibition of unreasonable or discriminatory measures set forth in Article 2, paragraph (2) of the relevant BIT, and then examined the Argentine government’s assertion regarding the state of necessity based on Article 4 of the BIT and customary international law. Article 4 of the BIT provides that Nationals or companies of either Party whose investments suffer losses in the territory of the other Party owing to “war or other armed conflict, revolution, state of national emergency, etc.” shall be accorded treatment by such other Party no less favorable than that accorded to its own nationals or companies or to nationals or companies of any third country.

The arbitral tribunal stated that Article 4 of the BIT provides for a specific expression of the national treatment and most-favored-nation standard in relation to compensation for losses resulting from certain actions, and that the relevant BIT does not contain exceptions corresponding to Article 11 of the U.S.-Argentine BIT.

Regarding the state of necessity under customary international law, the arbitral tribunal pointed out that the relevant BIT is supposed to preclude the invocation of a state of necessity, and that Argentina would not be entitled to invoke necessity to unilaterally revoke vested rights designed precisely to operate in situations where a run on the currency would lead to a situation of necessity. Furthermore, the tribunal stated that even if the state of necessity is admitted, Argentina remains obligated to pay compensation. While reserving
judgment on whether the International Law Commission’s Draft Articles on Responsibility of States for Internationally Wrongful Acts, which relates to responsibilities among sovereign States under international law, can be applied to private individuals, the tribunal examined Article 25 of the ILT Draft Articles in line with the Argentine government’s assertion, and determined that as the state of necessity should be “a most exceptional remedy subject to very strict conditions,” the measures taken by the Argentine government in this case cannot be deemed to meet the “very strict conditions” and therefore Argentina is not entitled to invoke necessity under customary international law.

(iii) Continental Casualty Company v. Argentina (ICSID Case No. ARB/03/9), [Award], September 5, 2008

Summary of the Award

a) General and security exceptions under the relevant BIT and the state of necessity under customary international law are identical in their intention and practical results, but different in their nature and conditions of application.

b) As requirements to admit general and security exceptions under the relevant BIT, it is not required that “total collapse” of the country or a “catastrophic situation” has already occurred at the stage of taking measures.

c) When a third party appreciates the application of the relevant BIT, the State may enjoy “a certain margin of appreciation.”

d) The necessity of the measures under the relevant BIT shall be judged in accordance with the requirements set forth in Article XX of the GATT.

Insurance companies in Argentina are obliged to invest a certain percentage of their assets in Argentina under regulations of the State, and CNA ART, which is an Argentine corporation owned by U.S. company Continental, made investments both in pesos and dollars. Continental requested arbitration, alleging that the series of measures taken by the Argentine government because of the economic crisis constituted a breach of the U.S.-Argentina BIT. In response, the Argentine government insisted that it had not breached substantive obligations and asserted the state of necessity under Article 11 of the relevant BIT and customary international law.

The arbitral tribunal firstly examined whether Article 11 of the BIT is applicable, holding that if the application of that Article is admitted, detailed examination of the state of necessity under general international law would be unnecessary. As a prerequisite, the tribunal referred to the differences between the two, pointing out that Article 11 of the BIT is a safeguard clause to restrict substantive obligations, while the state of necessity under customary international law is a ground for precluding the wrongfulness of an act. Furthermore, the tribunal stated that the two regulate different targets and have different conditions of application, as the necessity under customary international law should only be accepted on an “exceptional basis” that meets strict requirements, while Article 11 of the BIT is not necessarily subject to the same requirements according to its language and purpose. However, holding that they share the same intention and practical results, the tribunal decided to refer to customary international law only insofar as the concept there used assists in the interpretation of Article 11 of the BIT.
The arbitral tribunal admitted that the scope of the concept of “public order” and “security interests” set forth in Article 11 of the BIT is wide-ranging and that the Article can be applied even to economic crises, and that it cannot be denied that “the maintenance of public order” and “the protection of essential security interests” of Argentina were in danger under the circumstances in this case. The tribunal stated that measures for protecting “essential security interests” do not require that “total collapse” of the country or a “catastrophic situation” has already occurred before applying the Article. Furthermore, the tribunal pointed out that the Article does not allow discretionary power of a State invoking the state of necessity but that, as the relevant Treaty is a bilateral mutually-beneficial treatment, when objectively appreciating the application thereof, the State that takes the measures may enjoy “a certain margin of appreciation.”

Regarding the necessity of the measures, the tribunal stated that it is appropriate to refer to the GATT and WTO case law, which has extensively dealt with the concept and requirements of necessity set forth in Article XX of the GATT, on the grounds that Article 11 of the BIT derives from Article XX of the GATT. The tribunal concluded that “the necessity” of a measure should be determined through a process of weighing and balancing factors, such as [i] the relative importance of interests or values furthered by the challenged measures, [ii] the contribution of the measure to the realization of the ends pursued by it, and [iii] the restrictive impact of the measure on international commerce, and that when there is any alternative measure that is reasonably available to achieve the objectives, “the necessity” of the measure in question cannot be admitted.

Applying these standards, the tribunal admitted that the series of measures, excluding the long overdue restructuring of government debts, are material or decisive in order to react positively to the crisis and are “necessary” under Article 11 of the BIT. The tribunal stated that the abolition of the convertibility regime at an early stage cannot be an alternative nor can any alternative measures be deemed to have been available, and concluded that this case meets the requirements for the exclusion of the application of Article 11 of the BIT.

In cases where the State damages its own “essential security interests,” any measures taken therefor cannot be deemed to be “necessary,” but the tribunal held that as the series of policy measures had been appreciated as being sound, the Argentine government shall not be precluded from invoking Article 11 of the BIT due to its actions.

The arbitral tribunal upheld most of the allegation of the Argentine government based on Article 11 of the BIT, and only admitted a breach of the fair and equitable treatment obligation in relation to the restructuring of government debts.

(iv) National Grid PLC v. Argentina, [Award], Ad hoc—UNCITRAL Arbitration Rules, November 3, 2008

Summary of the Award

a) A breach of the relevant BIT shall be determined by taking into account all circumstances including economic crises.

b) The fair and equitable treatment obligation is not an absolute parameter and the threshold for admitting a breach of the fair and equitable treatment obligation can vary depending on the situation.
c) The relevant BIT shall not preclude the invocation of the state of necessity under customary international law against the obligations under the BIT.

A British company, National Grid, is a major shareholder of a power supplier Transenar. National Grid requested arbitration, alleging that the measures introduced by the Argentine government because of the economic crisis infringed the promise and guarantees, which were the prerequisites of the investment, and constitute a breach of the U.K.-Argentina BIT.

While admitting that the series of measures taken by the Argentine government constitute a breach of the fair and equitable treatment obligation set forth in Article 2(2) of the relevant BIT, the tribunal pointed out that it should take into account “all circumstances” to determine whether such measures are in breach of the relevant BIT and the critical circumstances that Argentina had faced cannot be ignored. Furthermore, the tribunal stated that the fair and equitable treatment obligation is not an absolute parameter, and referred to the possibility that what would be unfair and inequitable in normal circumstances may not be so in a situation of an economic and social crisis. Accordingly, the tribunal determined that only the measure taken on June 5, 2002, i.e. requiring the claimant to renounce the legal remedies as a condition to re-negotiate the concession, constituted a breach of the fair and equitable treatment obligation and that the measure also was in breach of the obligation to provide “protection and constant security” set forth in Article 2(2) of the BIT.

The tribunal further stated that the relevant BIT contains no agreement to preclude the possibility of pleading the defense of the state of necessity under customary international law, and examined the requirements listed in Article 25 of the Draft Articles on State Responsibility. The tribunal determined that Argentine internal factors, such as the fiscal deficit, indebtedness and rigidity of the labor market, caused the deterioration of the crisis, and the government’s crisis responses have worked to further increase the crisis; and therefore the requirements set forth in Article 25(2)(b) of the Draft Articles are not met. The tribunal concluded that the defense of the state of necessity under customary international law cannot be admitted.

(Reference 2) Major Disputes by Industry

The foregoing summary of major cases focused 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 more recent 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 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 illegal 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 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, CNTS 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 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 its existing agreement with Petroecuador. After the replacement of the agreement, Occidental found it could no longer receive reimbursements of the 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 the 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 voided the agreement 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 or management fees. 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.

Construction of Power Plant

PSEG Global Inc. and Konya Ilgin Elektrik Uretim ve Ticaret Limited Sirketi v. Republic of Turkey, ICSID Case No. ARB/02/5, Award, January 19, 2007

PSEG, a U.S. company, planned a BOT (Build, Operate, Transfer) project for a coal-fired power plant, and started a feasibility study after getting a permit from the Ministry of Energy and Natural Resources. During the negotiation for a BOT contract, the domestic legal system applicable to the project was changed many times. Among others, there was a change related to required company structure, as the result of which the project company was changed to a Turkish corporation rather than the subsidiary of a Dutch company that PSEG had planned at the beginning. Because of this, PSEG was penalized by tax assessments and lost a Ministry of Finance guarantee. Due to an increase in the expected cost of coal mining and the insertion of an arbitration article into the contract, PSEG faced difficulty in
negotiating the price at which the government-affiliated company would purchase power. Ultimately, the BOT contract was not concluded and PSEG requested arbitration, claiming that the Turkish government breached the fair and equitable treatment obligation under the U.S.-Turkey BIT.

In the process of the negotiation, the arbitral tribunal admitted a breach of the fair and equitable treatment obligation, pointing out serious negligence and inconsistent acts by the Turkish government, by not disclosing important points of disagreement. It further pointed out that the Ministry of Energy and Natural Resources made a request to the claimant that exceeded what was authorized by law, and that the Ministry did not conduct negotiations corresponding to the change in the law. With respect to the amount of compensation, the tribunal concluded that the feasibility study for the project was conducted although the construction of the power plant did not start, and ordered a payment to the claimant of 9 million dollars, the amount the companies other than the claimant had paid being deducted.

Service to Public Sector

 Siemens A.G. v. The Argentine Republic, ICSID Case No. ARB/02/8, Award, February 6, 2007

 Siemens, a German company, established a subsidiary in Argentina, and made a successful bid for a contract to develop an immigration control system and to produce and distribute national identity cards. Later, there was a regime change, and under the new regime, the government requested renegotiation of the price of ID cards and an increase in the number of the cards that would be delivered free-of-charge. The project had started, but was quickly halted, and the government and Siemens started renegotiation of the contract. In November 2000, Argentina had an economic crisis and enacted the “Economic-Financial Emergency Law,” which empowered the President to renegotiate public sector contracts, and the contract concerned became a subject of renegotiation. In May 2001, based on the law, Argentina issued Ordinance 669/01 and terminated the contract. Siemens submitted to arbitration, claiming that these acts breached the U.S.-Argentina BIT.

The arbitral tribunal accepted the claim that the contract termination constituted expropriation, and held that compensation must be paid. It further accepted the claim on the breach of the fair and equitable treatment obligation. As the grounds for the decision, the tribunal pointed out that renegotiation of the contract only for the purpose of alleviating burden without declaring public interest negatively affected the legal stability of the investment by Siemens. It also held that the Argentine government, which agreed in the contract to conclude agreements with its provincial governments, insisting that it was unable to do so for the reason of domestic structure, constituted breach of the principle of fairness. As compensation, the tribunal ordered the Argentine government to pay Siemens about 217 million dollars as the total of the value of the investment, consequential damages and unpaid services. The tribunal, however, rejected Siemens’ claim for a further 124 million dollars in lost profits.

Construction of Roads

 Desert Line Projects LLC v. Yemen, ICSID Case No. ARB05/17, Award, February 6, 2008
Desert Line Projects (DLP), a construction company organized under the laws of the Sultanate of Oman, concluded a contract with the Yemeni government and began the construction of asphalt roads. However, in the middle of the construction work, disputes arose between DLP and the Yemeni government over the work volume, and both parties requested arbitration based on Yemeni law. The arbitral award ordered the Yemeni government to pay about 108 million dollars to DLP. The government applied to Yemeni courts for annulment of the award, but during the proceedings, concluded with DLP a settlement agreement to almost halve the compensation granted in the award. After receiving a part of the compensation from the government, DLP requested arbitration, alleging that the settlement agreement was imposed and therefore void and that the acts of the Yemeni government constitute a breach of the Yemen-Oman BIT.

The arbitral tribunal stated that the settlement agreement, which is to renounce more than half of the amount granted in the arbitral award, can only be valid if it is the result of an authentic, fair and equitable negotiation. Noting such facts as that DLP was almost bankrupt when it signed the settlement agreement, that the construction site was besieged by the government, and that some managers were arrested and DLP’s physical security was under threat, the tribunal determined that DLP had no practical alternative other than to accept the settlement at that time, and so the settlement agreement was imposed on it. The tribunal concluded that this amounts to a breach of the fair and equitable treatment obligation under the BIT and that the settlement agreement is not entitled to international effect. Regarding compensation, the tribunal admitted the binding force of the Yemeni arbitral award and ordered the Yemeni government to pay to DLP the amount that remained after subtracting the amount already paid from the amount granted in that award (about 3.6 billion Omani Riyals), as well as 1 million dollars for moral damages and simple interest of 5% per annum.

Telecommunications

*Rumeli Telekom AS. and Telsim Mobil Telekomikasyon Hizmetleri AS. v. Kazakhstan.*
ICSID Case No. ARB/05/16, July 29, 2008

The claimants, Turkish companies, established a joint venture, KaR-Tel, jointly with a local corporation, Investel, and acquired a GSM license from the Ministry of Transportation and Telecommunications of the Republic of Kazakhstan for 67.5 million U.S. dollars. KaR-Tel concluded a contract for the establishment and examination of a GSM-standard communications network with the Investment Committee. Three years later, the Investment Committee cancelled the contract with KaR-Tel on the grounds of a breach of contract. Subsequently, the local partner filed a suit against the claimant with a domestic court to demand the redemption of the claimants’ shares in KaR-Tel. The claimants fought against it, but the Supreme Court admitted the compulsory redemption of shares. The claimants requested arbitration, alleging that these acts taken by the government of Kazakhstan breach the Turkey-Kazakhstan BIT.

The arbitral tribunal concluded that the Turkey-Kazakhstan BIT does not provide for fair and equitable treatment obligation, but under the most-favored-nation clause in that BIT, the fair and equitable treatment shall be enjoyed equally in conjunction with the U.K.-Kazakhstan BIT. The tribunal then stated that the cancellation of the contract without proper procedures as provided in the contract ignored the reasonable and legitimate expectations of investors. The tribunal further stated that the investigation by the Working Group, which was established to investigate the contract with KaR-Tel, lacked transparency and due process in
that it found KaR-Tel’s default without providing the claimants with any real opportunity to present their position. Based on that statement, the tribunal determined that the acts of the government of Kazakhstan were in breach of the fair and equitable treatment obligation and admitted the allegation of expropriation as well (refer to 2)(d)(iv) above). The tribunal stated that the fair market value of claimants’ shares at the time of the expropriation is appropriate for the compensation and ordered the government to pay to the claimants 1.25 million U.S. dollars and the interest thereon from October 30, 2003, when the Supreme Court admitted the compulsory redemption of shares, until the date of the payment.